Challenge

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letters TO THE EDITOR

Challenge invites your comments. Address letters to CHALLENGE, *475 Fifth Avenue, New York 17, N. Y.*

True or false?

• Again the editor who frames your quiz and writes the answer has proved that he neither knows your journal nor much else.

No. 1: Nothing is stated on page 20 about Jefferson [*The Other America*, February, 1959]. And during his Presidency there were no Latin American regimes to which he could extend diplomatic recognition.

No. 5: The article on page 8 [*The Economics of Foreign Policy*, February, 1959] deals with self-sufficiency in food, not with general self-sufficiency, nor did it state that the U.S.A. and Russia are the most nearly self-sufficient economies in the world. There are many countries which are self-sufficient in food, e.g., Australia–in fact, most food exporting ones. On the other hand, the U.S.A. is not self-sufficient in raw materials like wool, copper, etc; we do not produce tin at all. Most self-sufficient is probably China.

H. NEISSER

New School for Social Research
New York, N. Y.

No. 1: Prof. Neisser is right, the author is wrong. Although Jefferson was willing to recognize Latin American revolutionary regimes, he never had the opportunity to do so.

No. 5: On page 9, Prof. Morgenthau states that "the United States and the Soviet Union are most nearly self-sufficient in the raw materials of modern industrial production . . ."

African protest

• I have traveled extensively and know Africa quite well. Who is Mr. Cowan? [*African Promise*, February, 1959.] I'll wager he has never been to Africa in his life.

D. MERCER

Bloomfield, N. J.

Initial danger

• In your February issue, you run a gamut of initials that tells more history than you perhaps realize. Notice how they skip around. When we had the New Deal and its NRA, AAA and WPA, the Germans came roaring up with OWK and G(es)T(a)P(o), and the Soviets were ringing changes on MVD and GPU. Now we are operating with ICA, DLF, CCC, and IMF, not to mention IBRD and IAEA. The G's seem to be the most dangerous.

It is just as well we haven't joined GATT.

BOYDEN K. FORBES

Quincy, Mass.

Free choice

• I have been subscribing to *Fortune* and CHALLENGE. I suppose if I had to choose between them I would drop my subscription to CHALLENGE.

CALVIN WEEKS

Lake Forest, Ill.

Sane

• Congratulations on your sane and informative discussion of trade with underdeveloped areas [*The Dilemma of the Haves*, February, 1959] and on a fine issue in general.

JOSEPH ABDELLA

San Diego, Calif.

Lovelorn

• An awful lot of Americans are worrying about what everybody is thinking about us. This seems to be a reflection of the unhappiness of the high school sophomore who isn't "popular," and the girl who doesn't get her quota of dates. Does it really matter if nobody loves us as we want to be loved? Who loved England when she was at the top of the heap? Lord Kitchener didn't run any public opinion surveys in the Sudan, but he got what he wanted.

ANSEL HOWE

Washington, D. C.

Banker interest

• Your profile on Eugene R. Black [February, 1959] seems to prove that the best principles for running a big international bank are not those of ordinary bankers. At least you make a point of Black's learning to be human in contradistinction to his lessons as a banker. How about persuading our banks to apply some of his ideas–he doesn't seem to be losing any money for the IBRD–to the poor, underdeveloped bank clients in the United States? How about some low-interest loans to eradicate suburban scurvy?

JOHN SORREL, JR.

Los Angeles, Calif.

Direct

• Directly or indirectly, most of the authors in your Feburary issue advocate that we spend more for foreign policy. They feel that we can afford to sacrifice some of the rewards of our labors so as to provide better refreshments at U. S. Embassy parties. How many of your authors asked that their checks be sent to the State Department?

JAMES LAKRITZ

Chicago, Ill.

Willing

• After reading Prof. Smithies' article [*The Home Front–Still Untouched?*, February, 1959], I found myself agreeing that we must spend more for foreign policy and that we can afford it. My desire for bigger and better consumer conveniences is not greater than my desire to use them in peace. I am even willing to make some sacrifices–but not until I see less evidence of government waste.

C. W. SCHWARTZ

Tulsa, Okla.

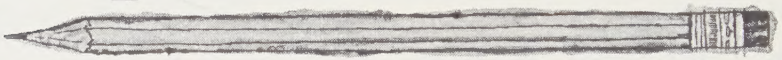
Reading list

• I hope that you sent copies of your February issue to the nation's college libraries. It's a good foreign policy review.

M. N. MORTON

Walnut Hill, Calif.

a personal note



from the editor

Lines of communication between Oshkosh and Berlin

■ WORLD EVENTS march inexorably toward a climax over the Berlin issue; but in this country the preoccupation of the public appears to be with domestic questions. I am not entirely certain that this political narcissism is all wrong, for it would profit us very little if we should win a great diplomatic victory over Berlin, only to find that through inattention the nation has domestically been weakened by the self-aggrandizement of organized minorities, or been enervated by inflation or the economic disenfranchisement of the unemployed and underemployed. After all, I suppose the Berlin crisis and all other international crises will find a way to settle themselves in one way or another. (Note the laissez-faire optimism here, no doubt a consequence of the realization that either these things will be settled peaceably, or we shall all be sent to our final reward; so why worry.)

The arithmetic of inevitability is not so clear cut when we deal with domestic problems. Conditions at home can get better, or they can get worse; but whichever way they go, we shall have to go on living with them. Our individual responsibilities in this area of self-government are plainly plausible and unavoidable. Now, a question that comes to mind at this juncture is this: What would happen if the American people should suddenly begin to inundate their representatives in Congress with letters expressing their views on matters relating to foreign policy, in much the same spirit as the letters that regularly arrive at Capitol Hill on unemployment compensation, public housing, taxes, social security, inflation, government spending, farm policy, and so forth?

I am not suggesting that such letters never are sent to our legislators. They often are. But I am suggesting that by far the majority of correspondence from the electorate does not deal with the Berlin problem, the question of Red China, foreign aid and our position *vis-à-vis* the underdeveloped areas. I am suggesting that our representatives in Congress have a less clear picture of what their con-

stituents think about foreign policy issues than about domestic economic and political problems. I am suggesting that Congress, and the Administration, for that matter, must play the foreign policy medley "by ear," whereas on domestic matters they can interpret a liberally provided public score. As a consequence, I am wondering about the efficacy of the tools that Congress and the Administration employ to measure the public temper on general and specific foreign relations issues. I am wondering how far the American public has divorced itself from the important decisions that must be made regarding our global position, merely because of the feeling that such decisions are bound to father their own wisdom in their own good time.

In a society where democratic forms are seldom soft-peddled in the name of our republican structure, this question, it seems to me, is a vital one—even if the public has chosen to place the issue of war and peace in the lap of the gods. To be entirely practical about this, the gods we refer to are neither infallible nor superhuman. It should be pointed out that these gods, in this instance at least, are cast very much in the image of the public, being, if nothing else, public servants elected or appointed to office by public consent. One wonders whether at times these chosen few do not, in the privacy of their thoughts, pale before the size of the task that has been thrust upon them—and this without too much coherent direction from their appointers. Their only direct line to the people, aside from periodic letters and even rarer personal contact, comes from commentators, editors, writers and other "experts," who themselves are not the people, but really a select band of apostolic satellites who think they speak for the people. Perhaps to a great extent they do speak for the people; but this is not the same thing as the people speaking for themselves.

My point is not a negative one. I am not saying that we are badly advised by the experts or misgoverned by our officials. I am saying that if this democratically inspired nation is to live by the codes it preaches, people must express their opinions with as much force on foreign policy problems as they customarily do on domestic matters. Such public expression could, surprisingly enough, be as much fraught with wisdom as that of the gods, who, because of public default, have found themselves in sole possession of the problems of foreign policy. But this will happen only if the public speaks up, and then only if public officials are provided with the right wave band to listen to what is being said.—H.B.

Challenge Notes

Productivity and full employment; trade follows the flag; finding a secure market for U.S. securities; all alone

■ THE CRUCIAL PROBLEM of productivity has been largely overlooked in the current controversy on how best to enjoy full employment, price stability *and* growth. Yet, the experience of the postwar years shows that the chief danger faced by an economy committed to full employment is not price inflation but a slowdown in the rate of productivity advance.

Certainly, we have averaged less price inflation under a regime of relatively full employment than in the previous 50 years. In the last 10 years we have averaged an annual price increase of 1.75 per cent; the average annual rate of increase for the period 1897-1958 was 2.33 per cent.

The real danger about price trends during the postwar period has been their inflexibility. Prices have failed to decline even during periods of recession.

This price inflexibility has led businessmen, workers and investors to assume that what can't come down must eventually go up—and act accordingly. The result seems to have been a standstill in the rate of productivity advance in almost all industrialized countries where government has committed itself to maintaining full employment.

The problem is partly one of incentives. If management believes that (1) costs can only go up and (2) government will do everything in its power to keep factories working at maximum capacity, it will *plan* accordingly. When firms feel that they can count on expanding volume at higher prices, they will be reluctant to seek new efficiencies. In business, as in other fields, a feeling of security is not the best goad to invention.

Trade follows flag

One of the facts of cold war existence that American taxpayers (and their representatives in Congress) often find difficult to accept is that much of our economic effort in the international field is directed at political rather than economic objectives. As a result,

the effectiveness of much of our foreign economic policy must be judged by political rather than economic criteria.

The fact of the matter is that the two most powerful nations in the world today, the United States and the Soviet Union, are less dependent on international trade than any other modern industrial power. Last year, a fairly average trade year, U. S. exports accounted for only five per cent of our national income. Indications are that the ratio for the Soviet Union is not very much higher. By way of contrast, Great Britain's exports accounted for some 17 per cent of her national income–and her very survival depends upon her ability to earn the foreign exchange with which to buy essential imports of food and raw materials.

This is something new in modern economic history. From the beginnings of capitalism in the early 15th century until World War I, the "Big Powers" were invariably also the big trading powers. Spain, Holland and England all derived their power from their ability to control overseas raw materials and markets. The foreign policy of these countries was concerned with protecting and expanding the trading interests of their subjects. The flag followed trade.

This is no longer the case. Both the Soviet Union and the United States have, for different reasons, sought to wield political influence through trade. The tables have been turned. Today, trade follows the flag.

A secure market

The Treasury and Federal Reserve recently announced a formal inquiry into the government securities market with the aim of "improving the market's functioning and preventing speculative excesses."

This move is, of course, prompted by the Treasury's well-publicized difficulties in finding buyers for its securities. Since the Treasury's refinancing difficulties will add substantially to this year's swollen deficits, such an investigation will be welcomed by the taxpayer. We hope the investigation will not confine itself to "speculation," but will re-examine our whole debt-financing policies in an environment of moderate inflation.

All alone

The American Telephone & Telegraph Co. is promoting a new Polly Bergen album, "All Alone (by the telephone)," which is supposed to induce listeners to lift the receiver and phone loved ones in far-away places. At that, it might lead us to disconnect the phone in order to be all alone–without the telephone.–M. K.

Revolutionary regimentation makes the Chinese commune an Orwellian citadel—and a danger to the outside world

Commune-ism in China

by Sidney Klein

■ COMMUNE-ISM in China today represents a social, political, cultural and economic revolution which may ultimately dwarf in scope the French and Russian Revolutions. It directly affects the 550 million Chinese peasants, nearly one-fifth of the earth's population, now enrolled as commune members; it also affects a billion persons in Asia and Africa whose everyday lives will be touched by the success–or failure–of the communes. The pervasive influence of this experiment may reach out to the rest of the world.

What is so revolutionary about the commune? The Russian collective farm is also based on a cloyingly close life in common, but it permits a degree of individuality that the Chinese commune would find heretically bourgeois.

The communes are in an irregular state of development, so that it is virtually impossible to generalize about living conditions; but Western observers have been invited to inspect "advanced" communes which presumably show the direction of the movement. These model communes are in a military state of "attack" readiness. Nonessential persons are isolated, the aged in "happy homes" and the children in nurseries where they normally see their parents only on weekends. A harvest working day runs from 2:00 a.m. to 7:00 p.m., with one two-hour and two one-hour mealtime breaks; to this long day one hour of political instruc-

tion is added three times a week.

Communes normally contain 5,000 families, or about 20,000 to 25,000 persons. But one unit 40 miles northeast of Peking has a population of 300,000. Many communes are as large as U.S. counties.

Communes combine in one giant unit the functions and powers formerly disseminated among collective and privately owned farms, industrial and commercial units, military units, and educational, social and cultural organizations. Control has been centralized to an unprecedented extent. The individual becomes a jerkily articulated puppet soldier in a blue cotton uniform. The commune is to Chinese peasants what the state is to all citizens in George Orwell's *1984*. One shaken observer reported: "Artificial insemination, natural selection, temporary settlement of a part of the inhabitants in distant underdeveloped regions, early morning reveille, military drill –all these seem to be on the horizon."

The commune members are not allowed to own land or other means of production, nor even the major means of consumption. Private property is limited to clothing and trivial items. All members have "voluntarily invested" their other property–land, implements and usually homes–upon absorption into a commune.

The highly centralized communes provide free food, housing and medical-care centers, paying very little in terms of money or grain. Others provide fewer services and goods, substituting larger monetary or grain wages. The Chinese Communist party is encouraging the hypercentralized system because of the control feature.

It is presently expected that all the communes will use the incentive system–"to each according to his labor"–plus rewards for political reliability. "Doubters" would be penalized. But in late 1958, the piece work wage system was abandoned in industry in favor of straight wages, because the workers made considerably more money than the state considered proper in a Socialist nation. It would thus seem only a question of time before the commune piecework system is replaced by time rates, with the output of the most energetic peasants being made the norm.

The communes are managed by party members appointed to the commune committees by members of the communal congresses. The latter were carefully screened by the party before they were permitted to run in carefully controlled elections. Party-oriented committees direct the myriad commune activities. When crops are planted or harvested, agricultural

products processing factories built, transportation and communication facilities repaired or constructed, schools opened, and irrigation and electrification programs undertaken, it is because these actions serve the interests of the party and not the peasants' needs.

The communes are organized along military lines, each commune being considered a regiment, with the chief administrator as regimental commander. Battalions and companies of peasants, factory workers, schoolteachers and tradesmen carry out their specialized economic tasks like soldiers. They also receive military training and engage in military operations when necessary.

Crude and vestigial

Will this be accepted by the Chinese people? Perhaps the outstanding factor in the party's favor is the extreme poverty of the Chinese people. In the pre-Communist years, two-thirds of the real income of peasants consisted of insufficient, unnutritious food; clothing and shelter were crude and inadequate. China's per capita income in 1949 was less than two per cent of that of the U.S.A. In particularly bad years, some peasants would hibernate for the winter, moving as little as possible in order to save energy and reduce food intake. If the communes increase the real incomes of the peasants, past hunger can be a powerful argument for them.

A second factor is nationalism. The Han have always been a proud people, and the anti-Western propaganda has been unusually effective. The Chinese have made great sacrifices and achieved much in the past few years. If they did not win the Korean war, they certainly did not lose it; and they may be willing to endure more sacrifices for the sake of the growing national stature of China. Indeed, China threatens to outstrip Soviet Russia as the world's leading exponent of socialism. It was not mere coincidence that Khrushchev traveled to Peking to see Mao Tse-tung in 1958 and returned with his plans changed concerning the summit meeting.

A third factor is the pervasiveness of the Communist controls; most Westerners cannot conceive how far government power extends. More than five million handicraftsmen are in government-controlled cooperatives, while 70,000 industrial enterprises of private origin are under joint state-private management, with the private owners in a decidedly passive role. The state is the major or only legal buyer of grain, cotton and other major agricultural products. Life can be made very difficult, even by Asian standards, for noncooperative peasants.

To cope with large-scale resistance, the party can call out its large well-disciplined army, as it was necessary to do recently in southern and western China.

Prior to 1949, women were chattels with few if any legal rights. They were bought and sold; in times of famine, girl babies were drowned if they were unsalable. The Communists gave all women, young and old, married and single, complete independence, and encouraged them to lead active working lives on the basis of complete equality with men. Thus it is not surprising that women have been unusually willing workers. In one province alone, 262,000 restaurants, 341,000 nurseries and 20,000 tailor shops were set up to enable seven million women, most of them mothers, to join the communal labor force.

Conflict in loyalty

While the factors noted above suggest that the Chinese will accept *commune-ism,* a number of others suggest that the Chinese will, however, resist. Family ties, reinforced by the Confucianist emphasis on ancestor worship, are still entrenched in the Middle Kingdom. The commune emphasis on loyalty to the state will conflict with this older, more pervasive tradition, and the resultant friction could prove disastrous. Liu Shao-chi, one of the top six Chinese Communists, has urged the establishment of full-time nurseries for children in lieu of the temporary ones where youngsters are now kept only while their parents are working. There are plans to turn the elementary schools into boarding schools free of parental influences.

Chinese parents have economic as well as human reasons to oppose separation from their children, who represent insurance against the vicissitudes of old age. In old China, the aged lived out their lives in honor and leisure in their children's families.

A second source of friction lies in the centralization of authority in the communes. For thousands of years, Chinese peasants have independently tilled their own lands. If they did not rebel against the collectivization of agriculture in 1955 and 1956, it does not mean that they will not in 1959 or 1960. It seems impossible for people to have less room to develop and have less value as individuals. Serious conflicts are bound to appear–if they have not appeared already–and undermine the agricultural segment of China's economy. With more than 99 per cent of China's peasants in the communes, and with agriculture accounting for 60 per cent of national income, the communes *are* China's economy.

Other potential hazards lie in

the fact that the fruits of communal efforts are not being passed on to the members; rather, they are being appropriated by the state and reinvested in industry. The peasants have also lost the human satisfaction which they formerly received from land ownership. In the collective farms which preceded the communes, the members owned small plots of land, their homes, furniture, livestock and small farm tools. In the communes, they own practically nothing.

Can we make a prediction about success or failure? Definitely not; anything can happen. Despite numerous handicaps, in 10 years the Communists have managed to increase the industrial capacity of China most impressively. Concurrently, they also managed completely to socialize China's agriculture, industry and commerce. In the years 1950 through 1953, the Communist armies fought UN troops to a standstill in Korea, and Mao has attained a political position where the leaders of Soviet Russia require his prior approval on major policies. The achievement is impressive.

Communes elsewhere

How relevant is the situation in China to that of other underdeveloped countries? How likely is it that *commune-ism* will be tried in these other areas? In modern times, national hysteria comes easily, especially in the U. S. where we are constantly worried about foreign accomplishments and our own inadequacies. Unfortunately, in this case our apprehension is justified. The Chinese Communists have proven themselves master politicians, and if *commune-ism* succeeds in China, they will undoubtedly propagandize that it can succeed elsewhere.

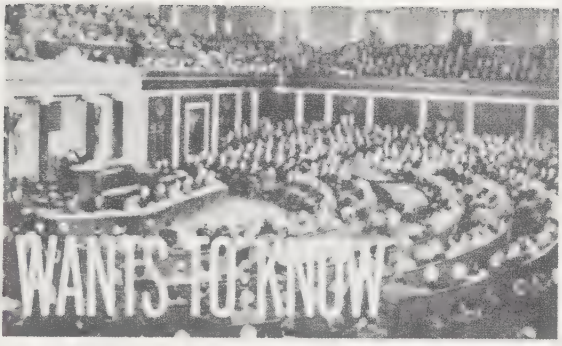
Another kind of commune has achieved a limited success. Israeli communes have functioned effectively since 1949, but they are based on a voluntary membership with powerful religious motivations. Moreover, they form but a small and static part of the Israeli economy.

In the late 1920s, communes were organized in Soviet Russia but were soon abandoned in favor of collective farms. Anastas Mikoyan, First Deputy Premier of the Soviet Union, and Ho Chi Minh, leader of Communist Viet Minh, recently stated that communes were unsuitable for their countries. On the other hand, communes are being organized on a large scale in North Korea.

Nonvoluntary communes represent the ultimate in enslavement of a people and in total mobilization for peace or war. They can be dangerously attractive to underdeveloped nations and should be watched carefully. ■

by Arthur L. Moore

CONGRESS WANTS TO KNOW



Inflation is the focus for legislative investigation as economists and price statistics converge on Washington

■ FOR TWO YEARS economists have been trooping to Washington at the invitation of Congress to tell all they know about the causes of inflation in modern industrial societies. One investigation alone–that of the Joint Economic Committee–produced several thick volumes touching on just about everything economic science has to say on the subject.

This concern with inflation is part of a world-wide shift in the way government leaders view economic problems. Old fears of mass unemployment which formerly dominated political economics are giving way to fears of a creeping wage-price spiral. Efforts are being made in all industrial countries to halt the spiral with new tools of economic policy.

Economists will be summoned to Washington again this year to testify in new inquiries. Their advice, as in the past, will often be conflicting. But since the 86th Congress convened last January, strategists of both Republican and Democratic parties have been displaying a new restlessness. They are deciding they cannot wait for economists to answer all the questions but must begin now to formulate new policies. They fear voter reaction should prices rise again before the 1960 presidential election. They are preparing their defenses on several fronts with a variety of ideas about what government should do to keep prices stable.

Perhaps the most surprising thing about the debate is that it is being so vigorously pressed in a year in which practically no

economist–or politician for that matter–expects important price increases. The consumer price index has been stable for almost a year. But on this very point, political leaders demonstrate they have not been seeking the advice of economists in vain. The hearings of the past two years have convinced most economic policy seekers in Washington of two things: (1) inflation is a long-range characteristic of the American economy and can be expected to continue; and (2) it is caused in substantial measure by forces not readily controlled by the traditional anti-inflation policies of credit restriction and balanced federal budgets.

Reassuring view

The debate begins one step beyond these points of general agreement.

One group, composed chiefly of liberal Democrats, asks: "What's wrong with a little inflation?" They ask for proof that the 2.6 per cent average price rise per year of the past quarter of a century has harmed the economy. For support among economists they cite the views of Prof. Sumner S. Slichter of Harvard and those who agree with him that limited secular inflation does less harm than any policy yet devised that could counter it.

This reassuring view is backed by respectable economic opinion; it is surprising that more politicians are not satisfied with it. One explanation is purely political: they are fearful that even small increases in the consumer price index will stir the wrath of voters. In addition, many economists have warned Congress that as the concept of a steady price rise takes hold and millions of people begin to make decisions based on it, the pace is likely to quicken. The safe creep could become a dangerous gallop. This warning is taken seriously both in Congress and the Administration.

Another group, also a minority, starts with the traditional view that inflation is caused today as in the past by a simple excess of demand: too much money chasing too few goods. The cure, then, is also simple: apply orthodox fiscal and credit restraint with a heavier hand. Only a few conservatives in both parties would really like to see this tried. Most economic thinkers in Congress and the Administration believe that these tools would have to be applied so rigorously that recession and high unemployment would follow. They regard such cures as more dangerous than the disease. Most economists agree.

One starting point shared by a growing number is that powerful unions cause inflation by pushing wages up faster than output,

thus forcing up costs. This is a belief widely held among Republicans. The President's economic message to Congress this year, calling on union leaders to exercise restraint, was peppered with references to the power of unions. An increasing number of Democrats are coming to believe that unions are at least partly responsible.

An opposing view is that the blame should really be put on giant corporations. The theory is that they have the power to raise prices even when demand is slack–as steel companies did in 1957–and that this power is the most dangerous inflationary force in modern society. The theorists define the situation as "administered-price inflation."

This idea gets its warmest support among Democrats. The President's economic message of last year, however, indicated some acceptance of the theory and warned business against price increases that are unwarranted by costs, or that try to recapture investment outlays too quickly.

Policy suggestions

Some of the searchers for new policies, borrowing a concept from the economists, think of wage-cost and administered-price inflation as essentially one process, referring to it as cost-push inflation. They are seeking methods of restraining the process without trying to apportion blame between either element.

From such starting points–all of them familiar to economists–what policy suggestions are emerging? Here are several being given special consideration:

• *Amend the Employment Act of 1946 to make a stable price level an explicit goal of government.* This has been proposed by the Eisenhower Administration and is backed by conservatives generally. Federal Reserve Board officials are for it. In hearings last year economists disagreed on its importance, but many thought it would be worthwhile on the grounds that the present wording of the Act might imply an inflationary bias.

The Act now states that the government shall promote maximum employment, production and purchasing power, but it says nothing directly about prices. The amendment would give equal status to price stability as a goal of policy.

The change is opposed by spokesmen for labor and some others. They fear it might be used by a conservative, inflation-conscious administration to seek stable prices at the cost of high unemployment.

• *Amend the antitrust laws to make it more difficult for corporations to practice administered*

pricing. Sen. Estes Kefauver (D.-Tenn.) suggests this be done by tightening up the laws against mergers. Breaking up existing corporate giants is another suggestion. In both cases the theory is that smaller corporations have a harder time influencing prices than large ones. Kefauver has been developing this idea as an inflation cure in a succession of hearings by the Senate Antitrust Subcommittee, backed by a large professional staff and consulting economists. The pricing policies of steel and autos have been studied in detail, and now baking, drugs and farm equipment will come under scrutiny.

Unexpected opposition

Selecting big corporations as the chief inflation culprits appeals politically to many Democrats and, naturally, to union labor. But going all the way and breaking up the giants stirs opposition in unexpected places. Walter Reuther, President of the United Auto Workers, believes administered pricing contributes to inflation, but he is opposed to breaking up General Motors, for example.

• *Empower the President or someone acting for him to investigate major price and wage increases before they go into effect.* For years there have been suggestions that large corporations should be summoned to Washington to justify price increases before some public body like the Federal Trade Commission.

The important difference here is that union wage demands could also result in a hearing. A bill sponsored by Rep. Henry S. Reuss (D.-Wis.) and Sen. Joseph Clark (D.-Pa.) places the review function in the President's Council of Economic Advisers. No power to block wage or price increases would be granted, but hearings could be held whenever proposed increases "appear to threaten economic stability."

Both Reuss and Clark belong to the liberal wing of the Democratic party and have enjoyed strong labor backing. One labor leader has endorsed the idea of a governmental review of wage demands. Reuther has said it might be useful if prices were also going to be watched.

Improper interference

Eisenhower has always refused to intervene in wage disputes on the grounds that it is an improper interference with private decision-making. Business groups will strongly oppose the idea if it seems to be gathering any headway in Congress.

• *Establish a council of management and labor to strive for agreements on broad policies involving wages and prices.* This suggestion is most often ad-

vanced by thinkers in the labor movement. Solomon Barkin, Research Director of the Textile Workers Union, proposed it in testimony before the Joint Economic Committee of Congress. He said it should discuss price and wage policies "which would most nearly coincide with the national interest." Barkin concedes that a conference would probably accomplish little at the beginning, but he believes it could lead eventually to a consenus on broad policies.

Somewhat similar councils have been established in many Western European countries, where inflationary pressures since World War II have been much more severe than in the U.S. In most cases they have official government status. They have not, however, achieved noteworthy success.

Cautious attitude

Arthur Goldberg, special counsel of the AFL-CIO, has also proposed labor-management consultation. Sen. John Kennedy (D.-Mass.) advanced the same idea in recent discussions of inflation.

Business groups are maintaining a cautious attitude. The U.S. Chamber of Commerce, in discussing Goldberg's suggestion, said it should be "respectfully received." The Chamber wanted certain conditions, however: no government sponsorship whatsoever, and pledges by union spokesmen that they believe in the profit system, for example.

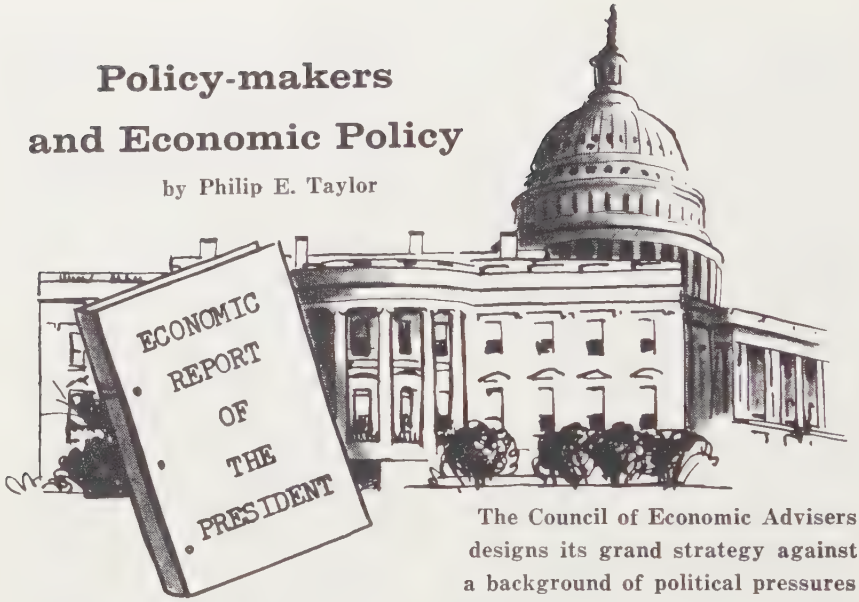
There are certain more familar anti-inflation weapons that always enter the discussion. President Eisenhower, for example, is making a balanced budget the heart of his economic policy this year as the necessary first step to keep inflation in check. Stand-by wage and price controls are often suggested, but they are unpopular in Congress and are opposed by the Administration. Stand-by controls over consumer credit, however, might be voted if demand should begin to rise sharply.

All policy ideas, new and old, will be reviewed this year by an Administration committee under Vice President Richard M. Nixon. Democrats will have the controlling voice in another painstaking inquiry by the Joint Economic Committee of Congress under the leadership of Sen. Paul H. Douglas (D.-Ill.), who will make effective use of his training as an academic economist.

Thus the stage is prepared for a major debate in political economics in which all participants will be seeking an answer to the riddle of modern industrialism: Can high-level employment and stable prices be brought into a harmonious policy, or must we eventually choose one or the other? ■

Policy-makers and Economic Policy

by Philip E. Taylor



The Council of Economic Advisers designs its grand strategy against a background of political pressures

■ IT WAS ONLY with the Employment Act of 1946 that our nation finally and formally recognized the importance of economic goals and disciplined economic thought in public policy. Are the Act's lofty objectives being fully served? Has professional economics made its maximum contribution to policy formulation? These questions are important not only to the nation but to the economics profession as well.

The annual Economic Report of the President–the major public performance of the Council of Economic Advisers–appears increasingly to be received by the public with a casualness quite inappropriate to its potential importance. There is not, one gathers, a widespread and intense hope among first-rate professional economists that they may some day be tapped for membership on the Council, though this statement is not to be taken as derogating the competence of those who have served. And the difficulties which the Council experiences in filling its senior staff positions indicate that what should be a responsible and rewarding professional experience is not widely so regarded. There are circumstances extenuating each of these observations, but they imply a role for economics in the public service less vital than many would desire.

The policy proposals contained

in the Economic Report in recent years have been unexciting and repetitive. They have tended to be declarations, without the backing of facts and statistics, largely unrelated to one another or to any stated major economic objective. The analytical chapters of the Report discussing gross national product or prices and foreign transactions and investment have been consistently useful and sound. *But the Report gives the reader little assistance on such major economic issues as the reasons for price increases or the slowing down of the rate of real economic growth.* The impression is either that economists do not have answers, or that it is impolitic to express them. Either interpretation is damaging to the profession.

But it is quite improper to judge the effectiveness of the economics profession by the Economic Report, particularly in recent years. The Council of Economic Advisers, as set up in the Employment Act, was handicapped by its peculiar structure. It had a Chairman without responsibility or authority *vis-à-vis* the Council itself. Instead, the Council acted as a composite economic adviser to the President, a situation that caused serious problems when disagreements arose among its members. Dr. Edwin G. Nourse [*see his article on a different subject,* CHALLENGE, *March, 1959*], after his resignation as Chairman, described the paralysis resulting from this situation.

In mid-1953 the Congress approved Reorganization Plan Number 9, making the Chairman alone responsible for Council activities, and vesting in the Chairman the role of directly advising the President on economic matters. This made administrative sense, but the Plan has downgraded the function of the Economic Report. If it has upgraded the potential effectiveness of a personal advisory relation between the Chairman and the President, it has not given the Chairman the power to balance that of the heads of established agencies and departments.

With the Reorganization Plan came two changes in the character of the Economic Report. The first was the abandonment of the practice of producing a midyear economic report. The second change was the dropping of the formal and published economic report of the Council *to* the President. Although the latter may appear to be an insignificant alteration of practice, it has, in fact, contributed to a decline in the influence by the various agencies.

Prior to 1954, the published Economic Report contained not only the President's report to the Congress, but the Council's review of the economy for the President. This latter tended to be

fairly straight economic analysis and description, with some policy implications of the analysis. This gave the Council an opportunity to appear as a professional economists' group before the public, to express itself independently and to emphasize its direct line to the President in economic matters.

Council's role

It was never expected that the Council should seriously recommend policies at odds with those of the Administration, for a responsible adviser works within the framework of established policy, pressing for a change in basic policy only privately. But the vehicle of the published report to the President did give the Council an opportunity to say what it and the President regarded as appropriate without prior emasculation by the various agencies.

With the loss of the Council's report to the President, the Economic Report has become only the report *of* the President to the Congress and the public. The Council's role is that of preparing the Report for the President, and the Council can put into that Report only what the President would or can say. But who decides what is or is not consistent with Administration policy in an area so broad and varied as economic policy? Under the "team" system, Administration policy is determined by consensus, and the Report finally contains only those things to which no one on the team objects. The result is likely to be an innocuous statement.

Let us take as an example the treatment of the federal budget in the 1958 Report. At the end of 1957 the Russians had two sputniks in space, and the U. S. economy was in deepening recession. Yet the budget for fiscal 1958, then half over, planned a deficit of one-third of a billion, while that for fiscal 1959 planned a surplus of $500 million. There was little cause for optimism in these decisions, nor could there be much confidence in the projections. The results showed how unrealistic these projections were: fiscal 1958 actually produced a deficit of $2.8 billion and fiscal 1959's expected deficit is nearly $13 billion.

What could the Economic Report possibly say to put a reasonable face on these officially accepted figures? One supposes that the only possible economic rationale–short of the politically impracticable one of welcoming recession for its cathartic effects–was that the projected 1958 deficit, though insignificant, might contribute just enough to the reversal of the downward trend to produce a prosperity level of national income before the beginning of the 1959 fiscal year. The projected surplus, the modest $500 million, would

then be useful for anti-inflation purposes.

Thin as this rationale would have been, it came out even thinner in the Report: "In view of the necessary acceleration of certain defense programs . . . national security expenditures may be expected to increase . . . Insofar as business activity is affected by the award of procurement contracts, it may rise earlier and more strongly than . . . national security expenditures." This was the extent of Council comment: only these two weak and uncertain sequences about the probable effect of budget decisions. One can almost see the Treasury's red-penciled note in the margin of the Council's stronger draft, objecting that while the Soviets may force a deficit upon us, we would never plan one for ourselves.

Bland documents

It is obvious that neither the Council nor its Chairman had much influence on a policy that resulted in such unplanned deficits. The role of the Economic Report had been reduced to the expression of a vain hope.

While Economic Reports since the Reorganization Plan of 1953 have become rather bland documents to the economic sophisticate, it does not necessarily follow that the Council is ineffective in the economic policy field. The intent of the Reorganization Plan was to personalize the advisory relation between the Council and the President, and it is evident that efforts have been made to place the Chairman in the main stream of policy determination.

The Chairman has fairly regular and frequent appointments with the President. He sits with the Cabinet regularly. As Chairman of the Advisory Board on Economic Growth and Stability, he meets weekly with high officials in major administrative agencies. He is, in short, a member of "the team." The potential advantages are, of course, that he is in a position to make his influence felt not only with the Chief Executive, but in the administrative agencies.

The disadvantages of this development, from the point of view of the impact of technical economic analysis upon public policy, are several. In an administration where policy decisions are not often made by the Chief Executive, but are distilled out of the give-and-take of staff discussions and maneuvers, the role of economic analysis may well become seriously diluted in the policy-making process.

Direct contact with the President is of limited value. In order for broader economic considerations to prevail in areas of essentially economic policy, the Chairman of the Council must not only

have developed an unassailable economic case for particular policies, but must also be a strong, convincing, nimble and highly respected person in his own right. While on occasion these qualities may be found combined with first-rate economic scholarship, the combination is by no means common. The heads of administrative departments are commonly chosen from the ranks of persons with established political or business reputations. The economist comes from a university or from a business or government staff position. While he may be highly respected in these circles, he will have to win the respect of administrators against some odds.

Economic collision

In addition, the Council is at some disadvantage because in several important areas economic analysis will frequently come into collision with rigid positions developed over a period of time by older agencies. The Bureau of the Budget is committed to minimum government expenditures and an annually balanced budget. The Treasury has been dominant in tax policy, but has permitted tax research to atrophy while pursuing rigidly the objectives of expenditure limitation and of tax reduction only when a sufficient surplus appears. In the face of these policy rigidities it would take a strong Council indeed to persuade the team to accept a flexible fiscal policy. The consequences of this disability are reflected in the current drive for a balanced budget. The anti-inflation rationale ignores the political pains of considering tax increases, and attempts to justify an expenditure level below what many regard as a necessary minimum for national security and economic growth. The disability was also demonstrated in the absurdly wrong and unrelated receipts and expenditures estimates in the 1959 budget, for the level of expenditure planned could hardly be of enough assistance to the economy to produce the receipts projected. In the realm of domestic minerals policy, under pressure from special interest groups, an administration oriented toward free enterprise and internationalism has embraced higher import taxes, import quotas, excessive stockpile purchases, production bonuses, and governmental research and exploration for private exploitation. It avoided further tax concession only because the Treasury, for revenue reasons, has resisted. Such policy limitations and inconsistencies as these indicate that economic advice has hard going under the present system.

The prospect for gaining or maintaining the sort of impact of professional economics upon pub-

lic policy contemplated by the Employment Act is not impressive under present conditions. What might be done to improve this situation in the Executive branch of government? There is, of course, no substitute for technical competence and a fine feeling for what is feasible on the part of an adviser. Assuming these qualities to be given, the problem is to make the adviser's influence count in policy formulation. In the competition for influence, the economist will surely be wise to stick to his last, leaving politics to the politicians. Since his distinctiveness is his capacity for economic analysis, he cannot permit himself to become simply another member of a political and administrative team. The revival of the annual report to the President would contribute to a re-establishment of the special status of the Council.

Too much overlap

The Council can accent the particular character of its function by emphasizing its relation to the Chief Executive and by resisting the temptation to pitch in and help out wherever a governmental problem arises. A degree of aloofness to noneconomic pressures within government should pay off in professional standing.

The creation in 1953 of a position of Economic Adviser to the President in the White House staff is fraught with danger to the effectiveness of the Council of Economic Advisers. There is far too much overlap with the personal advisory function of the Chairman of the Council.

But quite probably the most significant step forward would be for the Council of Economic Advisers to raise its own sights. Longer-term economic analyses are needed in many areas. We do not know enough about modern inflation, the impact of the fiscal system, the effectiveness of monetary policies, or about the nature and economic effects of modern competition. The Council's real effectiveness would be greatly enhanced if it could provide answers to these problems, and could orient its policy advice to the results of basic research. The present size of the Council staff will not permit extensive longer-term research along with present operations, which include carrying the day-to-day duties of evaluating proposed legislation, constructing replies to correspondence, writing speeches and preparing the Economic Report, along with myriad other activities.

The Congressional Joint Economic Committee has impressively drawn on outside resources for analysis of larger problems. The Executive is greatly in need of similar contributions from the Council of Economic Advisers. ■

NEW FRONTIER IN EUROPEAN TRADE

by Emile Benoit

The Common Market brings changes which require exploration if we are to continue our level of trade with Western Europe

■ THE YEAR 1958 may come to be seen as marking the end of the postwar transition period and the beginning of a new era. It saw the emergence of the European Economic Community, the Common Market of Germany, France, Italy and the Benelux countries—a market almost as populous and potentially as productive as that of the United States. The year also recorded a sharp drop in U. S. exports (by about a $4-billion annual rate between the first half of 1957 and the first half of 1958), and a sudden drainage of $2 billion of gold from the country.

Is the United States, as anxious observers ask, pricing itself out of world markets? Will European discriminatory regional markets exclude our goods? Is the U. S. gold drain an evidence of a "flight from the dollar," and does it pose a real danger to the U. S. economy? Or is the perennial problem of a "dollar shortage" solved?

Basically, the sharp break in our exports in 1958 reflected the severe recession in North America, the industrial slowdown in Europe and the world-wide decline in commodity prices. Canada, where the recession was acute, cut its U. S. imports by $700 million, and Europe cut its coal, steel scrap and other metal imports.

Our substantial gold losses in 1958 were due to the fact that, in contrast to our exports, our im-

ports hardly declined. This had, however, the fortunate result of persuading other nations that a U. S. recession need not have dire effects on their economies. Nor is the gold loss itself necessarily to be deplored. Since World War II, too large a proportion of the free world's gold reserves has been in the U. S. and far too little in Great Britain, which acts as chief repository for the Sterling Area. The recent gold shift has definitely improved this distribution. Indeed, it has largely made possible that very move toward European convertibility that some who deplore our gold losses so vigorously applaud. The U. S. export decline in 1958, however, was so much sharper than that of other industrial countries that it does make us ask if our competitive position has been weakened.

United Nations estimates indicate that the prices of U. S. exports of manufacturers rose five per cent more than the world average from 1953 to 1958. But these export prices had gone up four of that five per cent *before* the 1958 export decline began. In any case, relative movements of export prices fail to tell us whether U. S. export prices are higher or lower in an absolute sense than the export prices of other countries. Nor can they inform us whether the price differences reflect product differences.

We also have evidence that manufacturing costs of production tend to be lower in Europe than in the U. S. A 1958 study by the National Industrial Conference Board, called "Production Costs Here and Abroad," showed that in 1956 and the first part of 1957, a sample of American firms producing in Britain, Germany, France and Belgium had generally lower production costs in Europe than in comparable plants in the U. S. Wage rates are, of course, much lower in Europe than in the U. S.–by one-half to two-thirds. Since labor productivity is not so far below U. S. standards as are wages, the European wage cost per unit is still substantially lower. This factor is apparently important enough to overbalance Europe's frequently higher cost of materials and the occasionally higher overhead costs.

The generally lower production costs outside the U.S.A. are by no means universal. Thus, in the Conference Board Study cited, costs were generally found to be higher in Canada, Brazil and Australia, among others.

The danger is not that U. S. wages are rising at a faster rate than foreign wages. On the contrary, according to O.E.E.C. estimates, U. S. hourly wages in manufacturing have risen since 1953 by a substantially smaller percentage than in most European

countries (with Switzerland a striking exception). But U. S. wages are so very much higher already that even a somewhat smaller percentage of increase may add substantially to the absolute labor cost of the U. S. product. American unions are much less likely to moderate their wage demands out of a concern for the export competitiveness of the product than are unions in other countries where people are more vividly aware of their dependence on exports. It is hard to imagine, for example, American unions voluntarily accepting a five-per-cent cut in real wages, as the Dutch unions did in 1951.

Losing ground

The main danger is that U. S. productivity has been losing ground. European increases in manufacturing output per man-hour from 1954 through 1956 have been estimated by O.E.E.C. as follows: France and Belgium, eight per cent; Germany, five; the Netherlands, four; and Great Britain, two per cent. The rate for the U. S. over these years was only two per cent, while our historical average rate has been about 0.5 per cent. A chief reason for the U. S. productivity slowdown in 1956 and 1957, in my opinion, is the positive restrictions imposed on industrial growth by federal fiscal policies, largely out of a fear of inflation. I refer specifically to the nearly $7 billion of deflationary surplus in the cash budget of the federal government for 1956 and 1957. With the nation's plant being run at substantially below optimum levels of output, it has been impossible to achieve the full potential gains in productivity.

In applied science and industrial technology, our early postwar lead has visibly diminished. U. S. technology has been widely diffused through foreign licensing agreements or foreign operation of U. S. firms. Foreign research and development has concentrated less than ours on military end-products or on style changes and external embellishments, and more on improving basic design. Whether it be Japanese cameras, British power transformers, Dutch office machinery, Italian sewing machines, or French or German cars, the U. S. product is now faced with perilous competition on a quality as well as a price basis. This problem will not be licked by more salesmanship and advertising, but only by more attention to genuine product improvement.

The immediate impact of the European Common Market on U. S. exports will be slight. The initial intramural 10-per-cent tariff reductions extended by the six nations will have small effects, while special concessions have

been made to some nonmembers.

More significant is the liberalization of quantitative restrictions. According to the treaty, each Euromart country will now admit up to three per cent of its own domestic production of each item from its Euromart partners collectively. Thus, France, which formerly admitted only 6,000 cars from its immediate neighbors, must now accept 30,000. This advantage to Euromart members means a corresponding disadvantage to nonmembers like the U.S.

Some, but not much, offsetting benefit will accrue to U. S. exporters from the recent easing of currency barriers by Great Britain, Euromart and four other O.E.E.C. countries. Nonresidents trading in these countries can now use their new earnings of these currencies to exchange for dollars. However, *residents* of most of these countries are still unable to buy all the dollar goods they are willing to pay for, and few non-European countries are now earning any surplus of European currencies which they could exchange for dollars.

Severe discrimination

As the Common Market develops, U. S. exporters will clearly face more and more severe discrimination, with the Euromart internal tariffs dropping sharply and German and Benelux external tariffs mostly rising. French and Italian external tariffs will decline, but not as fast as the internal tariffs against the Euromart partners.

However, all U. S. exports to Euromart will not be adversely affected. Roughly 40 per cent of our exports to Euromart, comprising such basic commodities as coal, iron and steel mill products, scrap, cotton, and copper ore and concentrates will be little affected by tariff or quota changes, and should find expanding markets with Euromart's growth. Certain items like grains and fats, comprising over a quarter of our Euromart exports, may be adversely affected by the agricultural provisions of the Euromart treaty, but this is still uncertain. Only our manufacturing exports, comprising a third of our Euromart exports, are clearly endangered, and in many individual cases even these will be able to survive or expand, owing to the vast growth of demand anticipated within the Market and the qualitative superiority or special advantages of specific U. S. items.

But U. S. exports will suffer from stronger competition by Euromart producers. In the developing Euromart, many marginal producers will be illiminated or absorbed by mergers, new and strong companies will be formed, often with U. S. capital and tech-

niques, and efficient producers will expand to achieve the full economies of mass production. This strengthened competition will also be felt in Latin America, and other non-European markets.

Despite the tougher competition U. S. exports will meet, they may still remain at high levels. Dollar payments will probably remain high, and if other nations earn dollars, they will in the end spend most of them on U. S. products. This depends mostly on maintaining a high rate of U. S. imports. The recent renewal of reciprocal trade legislation in the middle of a recession suggests that the U. S. will not again revert to restrictive high-tariff policies. Our dependence on imported raw materials will grow rapidly in the future, and the U. S. has already become a net importer of petroleum, metals, forest products and many other critical raw materials.

Other payments going overseas will also continue high as far as one can foresee. U. S. tourist expenditures are on the uptrend. Private foreign investment has declined far less than domestic investment during the recession, and there is reviving interest in overseas manufacturing ventures and in portfolio investment. U. S. overseas military expenditures, an annual $3-billion item exclusive of military aid, will likely be sustained, and increasing amounts will be allocated to international development as our stake in the world is appreciated.

Putting these items together, it looks as though the rest of the world will continue to receive a liberal supply of dollars. Some of these dollars will no doubt go to swell foreign gold and dollar reserves, which are, however, far more nearly adequate than they used to be; those of Great Britain and Western Europe have roughly doubled since 1952. We can safely assume that most of the dollars spent abroad by the U. S. in the future will come back rather quickly for the purchase of U. S. goods and services.

If U. S. exports should prove insufficient to finance the imports we require and the other overseas payments we want to make, it would always prove possible to devalue the dollar. This, however, is clearly a last resort, and there is no indication so far that such a measure would be necessary in the foreseeable future.

Sooner or later we must learn to accept the disappearance of our traditional export surplus. We cannot indefinitely sell more than we buy. But this gap can best be closed by the acceptance of more imports rather than by the elimination of the exports which the rest of the world still needs, and which U. S. producers are eager to sell. ■

Challenge Profile

Paul-Henri Spaak— Mr. Europe

■ THE COMMUNIQUES announcing success in the Cyprus negotiations have ignored the name of the NATO Secretary-General. Such an omission would appear to be reasonable enough, since the office of Paul-Henri Spaak should be more concerned with Soviet intentions than with Mediterranean tempests.

Yet it was Spaak who helped bring representatives of Greece, Turkey and Great Britain to the point of realistic discussions. The 60-year-old Belgian would insist that he was merely minding his own business. Bearing with justice the title of "Mr. Europe," Spaak interprets his business in the broadest terms, and the North Atlantic Treaty Alliance was suffering from the quarrel about Cyprus among one-fifth of its membership.

With each issue CHALLENGE profiles a person whose thinking affects the pace of the United States economy.

A jowly *bon vivant* of 230 pounds, Spaak has an enormous but selective appetite for political office and good food. Belgium's youngest prime minister at the age of 39, he has spent most of his subsequent life as government leader or foreign minister while consuming quantities of *turbot poché* and *Meursault* wine.

So obviously a symbol of Europe's well-fed *haute bourgeoisie*, Spaak's appearance does not accord well with his designation as a member of the Socialist party. Yet, if he shows no present taste for doctrinal economics, he continues to move under the same impulses that once earned him the title of "Bolshevik in a dinner jacket."

Grandson and nephew of former prime ministers, Spaak became a union attorney and a left-wing Socialist. In the early Thirties he was urging the workers and soldiers to revolt, a biograph-

ical datum that must have distressed some NATO generals, and he tried to broaden a mine strike to a general strike in 1935. Spaak, who today urges people to learn from experience so that they avoid repeating the same mistakes, saw that he had made a mistake. The workers were more conservative than the political aristocrat, and the strike failed. Spaak became a gradualist so quickly that he was a prime minister in three years.

In a recent article Spaak noted that an American and a French worker earned eight pounds of bread by an hour's work in 1880, and while the American's portion had more than quadrupled, the French worker was still getting eight pounds in 1950. With socialism promising only a few more crumbs at best, Spaak plumped for the whole loaf of European unity and mass markets.

After accomplishing one more act of intransigence, the ejection of King Leopold III in favor of his son Baudoin, Spaak won a reputation as the best politician in Europe for leadership in establishing Benelux, the Coal & Steel Community and the Common Market. One observer said: "He is ruthless, daring, tactful, amusing, receptive and intellectually brilliant. He has the cunning of Machiavelli and the obstinate idealism of St. Francis."

Spaak's round ebullience had to triumph over many disappointments. But he has shown the same ingenuity that permitted his escape to England in 1940 in the false bottom of a magician's trunk. He was able to retain a "particularly stirring memory" of the hopes inspired by the impuissant Council of Europe, and to go on from that grand expectation to the more modest "functional" objectives of the Schumann Plan and Euratom.

The establishment of the Common Market, however, showed what was possible with carefully reserved hopes, as limited arrangements broadened into a more general union.

Spaak accepted his NATO post as a good soldier of European unity, ready to fight on any of several fronts. He has refused to regard the great alliance as purely military, and he is trying to emphasize those clauses of the treaty of alliance which permit economic and social cooperation.

With a now well-developed patience, Spaak can cheerfully wait the 12 to 15 years that will elapse before the Common Market's provisions are completely implemented. He recalls the indulgence with which people listened to his dreams for unity 10 years ago.

"Europe is no longer something to be prophesied," he recently said. "It is something which needs explaining."–D.F.

Experts use the latest techniques to predict swings in the economic cycle

by John McKnight

■ THE POSTWAR YEARS have brought a growing prevalence of year-end statements and predictions on the business outlook. Business magazines now present a complete survey at the beginning of every year. Economists and presidents of leading companies discuss prospects in detail. Additionally, economic and statistical associations, and groups such as the National Industrial Conference Board, hold seminars or luncheon meetings at which someone forecasts the business outlook, while the Department of Commerce or the Joint Committee on the Economic Report invite experts to give their opinions.

More and more, large companies are setting up and using economic forecasts as an aid to management decision, and as adjuncts to their departments of market research. The present-day corporation insists on having an informed estimate of the levels of business that may be expected over the short, medium and long term, so that it can make plans for the probable position of the company and its industry in the light of such an outlook.

The growing interest of business in economic forecasting has been paralleled by a growth in the interest of the federal government. The Department of Agriculture has, of course, been engaged in the forecasting of crop conditions, probable yields and supplies of farm products for many years. The staff of the Joint Committee on the Economic Re-

port presents a forecast of gross national product and disposable income over the year ahead. This is prepared to assist the Committee in its evaluation of the President's Economic Report.

Suspicion and interest

Academic economists have always looked suspiciously upon economic forecasting, a feeling that still exists. Nonetheless, there has been a growing interest in economic forecasting on the part of colleges and universities. Courses in business forecasting may now be found in many institutions, and the literature on forecasting by academic economists is growing.

Short-term forecasts can inform a manufacturing company as to what to expect in the business environment over a period of from three months to a year ahead. The forecast of the business environment will generally include the outlook for gross national product, personal and disposable income, industrial production, employment, hourly earnings, consumer spending and construction activity. In the light of these general forecasts, a company can pinpoint more specifically what is likely to happen to its industry. This is particularly true if demand for its products is affected sharply by changes in the general economy. For example, a company manufacturing containers can expect good markets in a particular year if the consumer industries that use these containers in packaging are likely to be thriving. Similarly, a steel company can anticipate high demand for steel if it knows that the construction, automobile, machinery and electrical equipment industries are likely to enjoy high levels of activity, and if steel inventories of these end-using industries are about normal.

A drug wholesaler will be particularly interested in the outlook for income by geographic areas inasmuch as the buying of drug products, as of many other items sold at retail, tends to vary with changes in income. An above-average rise in income in a group of states in a given year will normally be accompanied by an above-average increase in retail sales in those states in that year.

Companies which have been forecasting their sales for a good many years make use of these projections in many ways. They may use the sales forecast in the company's financial budget for the year. They may also use five-year sales forecasts in the preparation of company budgets and cash positions. The company's financial budget will also include operating budgets for each of the company divisions, all of which are tied to the forecast of sales. Thus, the

manufacturing division will be instructed on the amount of production likely to be required in the given year and over shorter periods. The division head can then plan his work force and materials inventory. Similarly, the sales and advertising directors will be given budget totals which are based on the sales forecast, and they can plan their operations accordingly.

Other uses

Industries other than manufacturing also use economic forecasts. An electric utility company would be concerned, for example, with the long-term power requirements of its region. A forecast of these requirements would have to take into account the expected growth in population over the period, the average levels of business likely, the potential demand for electric power by major types of customers–residential, industrial and small users–and the potential impact on electric power demand of other fuels or energy sources.

The investment department of a bank is interested in the outlook for specific industries as a guide to portfolio selection. It is interested as well in the outlook for general business–the economic framework within which particular industries will gain or lose. The commercial and consumer loan departments of the bank will be interested in prospective loan demand which would depend in turn upon the outlook for industrial production, consumer income and consumer stocks of durable goods. Reliable forecasts can be of great value to bank officers in the determination of general loan policy.

Are the forecasts accurate? There is no single answer to this. Perhaps the best reply is found in the fact that business firms are demanding an increased range and coverage of the forecasts that are supplied to them. Some firms want the forecast to be quite specific. For example, a department store owner will want to know the percentage increase expected in income in his selling area and, if available, the probable percentage gains in sales of the different departments of his store. A container manufacturer will want to know the probable sales levels in each of the industries using his containers, and will then ask his own market research department to estimate the impact of those changes on the company.

Undoubtedly, forecasts are sometimes inaccurate. Indeed, the errors in a given year may sometimes be large. However, if a forecasting service is worth its salt, it should be able to supply companies with generally reliable forecasts with only a moderate margin of error.

The margin of error can vary from industry to industry. For example, sales of most consumer perishable goods are relatively easy to forecast. Per capita demand for these products changes slowly over time, and the chief determinant of total demand is population growth, plus loss or gain of markets relative to competing products. Sales of clothing would be more difficult to forecast. This is an area where demand can be postponed, and where changing styles and competing materials can react sharply on sales of a particular type of clothing.

Still more difficult is the sales forecasting of consumer durable goods, such as passenger cars, electric refrigerators, television sets and other home appliances. Here, a number of factors come into play–factors such as consumer income available after spending for subsistence items in the budget, the rate of new households formed from one year to the next, the level of consumer stocks, relative price trends and replacement demand.

There is, next, that large group of products in the capital goods industries–machinery of all kinds, electrical and nonelectrical, machine tools, railroad cars and commercial vehicles–where demand is subject to wide swings, far greater than those of total business. It is possible to formulate analyses of demand for capital equipment, but the degree of prospective error will generally be larger than in forecasts of demand for other types of goods.

Many business firms are satisfied if the forecast of the economic outlook over the near term represents the kind of economic climate that lies ahead. They will be particularly satisfied if the forecaster is able to tell them when a turn in the business picture is likely. These firms are content with such general forecasts, choosing to estimate by themselves their probable sales performance in such an economic climate.

Confidence and attention

Generally speaking, business firms will increase their use of particular forecasts in direct correspondence to their confidence in the forecaster. A business forecaster is not going to be trusted very much if he misses major developments or major turns in the economy. It is safe to say that when a forecaster enjoys the confidence of management, his forecasts will receive serious attention. Management may decide to ignore the advice for other reasons. It will at least include the forecaster's advice in its thinking about the problem in hand.

How important were forecasts during the recent recession? Some

companies undoubtedly benefited from the prediction of an economic downturn given by some business forecasters during 1957. These benefits followed from inventory curtailment during that year, the shelving of plans for additional capacity, and the decision to ride the recession through on the ground that it would not be a long one. The majority of companies probably looked upon the forecast of a downturn with some misgivings. When business is strong, it is often hard to believe that a change for the worse is coming. The prevalence of this attitude probably explains why so many companies were caught short in the final quarter of 1957 and the first quarter of 1958. In addition, not all forecasters predicted a downturn at that time.

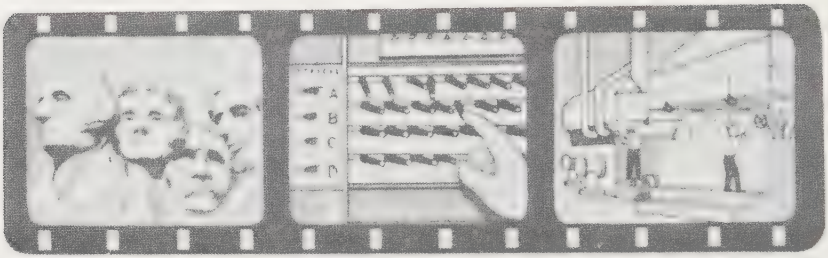
Forecasts of an early upturn made during the spring of 1958 were instrumental in sustaining business confidence and in inducing some retailers to add to inventory so as to be ready for a strong level of sales in the fourth quarter. However, the presence of conflicting opinions on the business outlook and on the timing of the upturn probably kept many companies from relying too much on any single prediction. Those companies which prepared for better business in the second half of 1958 and thereafter, on the basis of such forecasts made in the first and second quarters of the year, were in a stronger position by year's end.

Do forecasts come true because business lets its decisions be guided by them? No! A business forecast, particularly of a general nature, is based on much more than the reaction of business to the forecast. Factors leading to the particular result are already at work at the time that the forecast is made. Actions of business can perhaps intensify or hasten the predicted result, but to only a small degree. Similarly, business decisions intended to counteract the effects of a particular forecast will probably be helpful to the company or industry taking such action, but the net effect on the total picture is apt to be small. However, the impact of such reactions by business is likely to grow in the future inasmuch as more and more companies are giving serious attention to business forecasting. ■

Youthful

OUR YOUNGEST STATE has the country's youngest population. On a percentage basis, Alaska has more babies and fewer old people than any other state. About 24 of every 100 Alaskans are under five years of age but only four of every 100 are over 65.

Projecting the American Image



Re-emphasizing our own democratic traditions will help us win friends in underdeveloped countries

by Harvey J. Levin

■ IN THE POWER STRUGGLE between Communist and free nations today, the uncommitted, underdeveloped country plays a key role. Western officials devote more and more attention to the picture which our system presents in these countries where standards of living are painfully low, experience with democratic processes embryonic, and capitalist colonialism still a vivid memory.

In the mammoth struggle Western nations suffer at least three major drawbacks. One is the tremendous appeal, to peoples determined to industrialize quickly, of the spectacular growth of certain Communist economies. Another is the lurid picture of free economies widely disseminated by Communist spokesmen. A third drawback, of greatest concern because it is most within our power to alter, is an unfortunate and persistent flaw in our image abroad, for which only we are to blame.

Capitalism's defenders have long asserted that as the system churns out an abundance of goods and services, it also promotes such virtues as self-reliance, initiative, thrift, diligence, independence of thought and conscience. Indeed, many liberals say that, if necessary, they would sacrifice at least *some* efficiency, output, employment and income equality, to give individuals the greatest chance to develop their own capacities as they see fit. In other words, the competitive system is justified–aside from effects on efficiency, stability and growth–for its sal-

utary effects on human development and self-realization.

Now, these virtues may well exercise a strong influence on Western Europeans still undecided about communism. But they are often meaningless, if not ludicrous, to the East Asian or African who still faces severe problems of poverty and who is unimpressed with the claim that individuals can hypothetically realize their potentialities in the West.

The main question here is whether free economies, at best, produce a particular kind of person of little appeal outside the West; or whether we have ideals and traditions *besides the virtues of individualism* that may better capture the imagination of the uncommitted nations.

There *are* such other ideals and traditions, I believe, implicit in the agencies and institutions which free societies use when their members and constituent groups cooperate to attain collective goals. Cooperation and planning, no less than self-reliance, individual initiative and personal fortitude, played an important role in the settlement and development of America. Surely the physical hazards of New World colonization and frontier life required collective safeguards for securi y, health and sheer survival. In addition to provisions for the "free adventure of particular persons," the Massachusetts Bay Colony and early New England villages made important collective decisions on land distribution and use. Hamilton's *Report on Manufactures* proposed to accelerate our industrialization by a network of protective tariffs and bounties and the establishment of an institute to promote the industrial arts. Jefferson's Secretary of the Treasury, Albert Gallatin, formulated a remarkable plan for the federal construction of numerous roads and canals to facilitate general economic expansion and individual economic opportunity. Private business, unaided, seemed unwilling and unable to undertake such vital projects. The role of state and local government in promoting economic development before 1860 is another early departure from strict individualism.

Our constitutional framework itself attempts to strike a balance. The founding fathers created a centralized federal power sufficient to provide for collective ends like the common defense and general welfare. But the central government was checked, and its power diffused, by a separation between Executive, Legislative and Judiciary, by the bicameral legislature, by the reservation of powers to the several states, and especially by explicit guarantees of private rights and the doctrine of judicial review.

Do these past traditions and our current internal policies really affect our ability to win friends abroad? Suffice to note the apparent determination of such countries as India and Brazil to reconcile planning for collective goals with political democracy. The relation between deficient domestic policies and our diminished appeal was also demonstrated, again vividly, by Soviet skill in capitalizing on our recent recession and slow growth rate.

Multipilicity of views

Our failure so far is a failure to show all the best within us. Of course, this is no easy matter. One difficulty in presenting this more appealing face may arise from the very multiplicity of views within this country on the goals and instruments of economic policy. Without calling for any monolithic front, there would surely be fewer conflicts if our contending power groups agreed that social standards *can* be maintained, to a point, and collective goals pursued, in a free enterprise system; and that the laws and mechanisms which enable us to do so need not really reduce freedom of choice.

To be sure, concerted national economic planning has an undeniable psychological appeal to many underdeveloped countries which will doubtless figure importantly in the future balance of power among nations and ideologies. Yet some of these countries would be surprised to learn that government has gained increasing economic importance in advanced Western economies over the years, notwithstanding a basic commitment to individualism. In Western countries with per capita incomes of $800 or more, government's share of national output is reputed to range between 20 and 30 per cent, compared to a mere six to 15 per cent in countries with per capita incomes of less than $100. Even more pertinent is the rise in our own government's share of the nonagricultural labor force, from 10 to 15 per cent between 1919 and 1958, and the growth of its share of gross output, from 7.2 per cent in 1902 to 27.7 per cent in 1956, or, excluding defense, from six to 15 per cent. If governmental participation in the solution of emerging economic problems is one of the keys to a favorable image in the new lands, the West need not sell itself short.

Dual conditions

As long as we are already committed to seeking for ourselves an effective *balance* between collective goals and decentralized decision-making, it serves us poorly in East Asia and Africa to present these dual conditions of a

viable society as necessarily inconsistent. Not only does the survival of our own "way of life" require both, but numerous examples already exist to dramatize abroad how a mixed capitalist economy may try to reconcile individualist and collective traditions. Surely our high esteem of free economic choice has not excluded serious governmental attempts to stabilize the economy by fiscal and monetary policies, and sometimes even by direct wage-price control. Nor has our commitment to a distribution system based on material rewards for individual merit and productivity seriously clashed with redistributive measures like taxes on inheritance, gifts and incomes, or public expenditures on roads, parks, schools, hospitals, museums, and so on. Even our traditional devotion to wide discretion for consumers is limited by building codes, zoning laws, the Food and Drug Administration, the Federal Alcohol Administration, the Bureau of Narcotics, and proscriptions against obscenity. The worker's right to learn from his past mistakes in the free choice of occupations is hardly undermined by laws on sanitation, safety, accidents, work posture, wages and hours. These admittedly imperfect attempts to reconcile individual discretion with standards of welfare are at least indications that we are more concerned with human dignity and self-respect than our critics often allege.

Equally indicative of our partial success in dovetailing diffused power and superior economic performance is the creation of public corporations like the Tennessee Valley Authority or Bonneville Power Administration, accountable to Congress, but autonomous in daily operating decisions. Contractual arrangements employed by the Atomic Energy Commission and other procurement agencies well illustrate our own ingenuity in harnessing private initiative to collective ends.

Traditions and values

Such innovations, and their antecedents much earlier in our history, express American traditions and values at least as much as the more familiar individualist caricature. But the caricature will remain until we are less reluctant to face up to what we really are. A fuller awareness of our past traditions might bolster American self-confidence and imagination at a time when bold steps are needed to cope with new challenges abroad. Most important, it would help us discover some workable *equivalents,* in rather different foreign settings, to the balance we are trying to strike at home between diffused power and superior socio-economic performance. ■

Austin J. Tobin

Executive Director,
The Port of New York Authority

Private Side of A Public Business

Q *Mr. Tobin, how far back does the authority concept of doing business go? Is it a new idea? Is it an old idea?*

A The first modern authority, as we think of it, was the Port of London Authority, established in 1908. The Docks and Harbors Board, although not called an authority, also was one of the first modern British public corporations of this type. The Port of New York Authority was the first of its kind created in the United States.

Q *When was it instituted?*

A There is a clause in the federal Constitution that permits states to enter into compacts with the consent of Congress. In 1921, the states of New York and New Jersey, having the common, natural advantage of the great port of New York, settled many, many years of controversy and rivalry by the creation of a joint port district. As a consequence, The Port of New York Authority was created to administer and finance, on a self-supporting basis, the public terminal and transportation facilities of this bistate port district.

Q *Exactly how was this Authority supposed to be run?*

A The men primarily responsible for the adoption of the Authority idea came up with what at that time had to be some politically startling ideas. The agency would be self-supporting; it would have no

call on the tax resources of either state, and it would have no power to pledge the credit of either state. Although this was to be a bistate agency, dealing on a continuing basis with administrations in both states, it would nevertheless have to be strictly and rigidly nonpolitical. They also came up with the very interesting idea that the men who would run it, the directors, or, as they call them, the commissioners, should receive no salaries or other compensation. With that went the idea that the agency would have to have a career staff that would also be nonpolitical, recruited on a competitive basis and promoted on such a basis. Along with this rather revolutionary concept of a public agency in the United States, it was also felt that the management of the agency, its administrative and accounting practices, should be similar to good American corporate business management.

Q *Mr. Tobin, how is this bistate Authority different from other public service enterprises?*

A This public corporation, this Authority, is self-supporting. We must get money from private sources–insurance companies, banks, individuals–and the only security these people have is our pledge that our revenues will be used only to pay the interest on their bonds, and ultimately, to repay the principle on their bonds.

Q *In other words, you must retain your credit rating.*

A We must retain our credit rating. Now, this is sharply distinguished from all sorts of prime public services that our municipalities must provide, our schools, our highways, our police forces, our sanitary forces. All of these things are essential to the public interest, and have to be supported out of general or other types of tax revenues. There is no inference here that one way is better than the other. One type of service lends itself to a particular type of public financing, and the other simply does not.

Q *Keeping in mind these limitations, what has the Authority done? What has been the range of its activities?*

A The Authority has gone forward with the construction of interstate bridges and tunnels; with the reconstruction and new construction of marine terminals in New Jersey and New York; with the construc-

tion of the airports in the metropolitan region; the construction of bus terminals and motor truck terminals. Also, if anything can be more important than these accomplishments of concrete and steel, we have had a constant program, if you will, a sales program, a promotional program to see to it that foreign trade continues to flow through the port of New York-New Jersey.

Try to sell advantages of shipping through port of New York

Q *Is this promotional activity a major effort?*

A I should say so. There is intense competition between New York and other East Coast and Gulf ports. We actually budget $1 million a year for what we call port promotion and development. This has to do with appearing, on behalf of the port, before the Interstate Commerce Commission, the Maritime Administration, or the courts in rate cases, and in cases involving air routes in and out of the metropolitan area. It involves maintaining offices on the continent of Europe, England, South America, in the Caribbean, Chicago, Cleveland, Washington, D. C., New York–all working to make it attractive to ship through the port of New York, trying to sell the advantages of shipping through New York. It is not generally realized that some 430,000 people are employed directly through the operations–the marine operations only–of the port of New York. There are 430,000 people, with something like $2 billion a year in payrolls involved.

Q *Mr. Tobin, there are many public service operations that are uneconomic. What keeps the Authority, on the strength of its solvency, from becoming involved in some of these uneconomic services?*

A Well, if the commissioners of the Port Authority went ahead and plunged into operations that were uneconomic, the Authority would soon find itself unable to repay its debts, or even to pay the interest. That would be the end of the Port Authority, and the end of its usefulness. It would be the old story of killing the goose that lays the golden eggs.

Q *How closely does the Authority define what it is going to do with the money it borrows?*

A Of course, people will not lend you money just on what we call an

"open-end" contract–just lend us money and let us go away and do what we please. When we borrow money, and we have borrowed a billion dollars up to now, we have to make commitments to the bondholders that are written on the bond indenture itself. We must agree that we will maintain a reserve of 10 per cent of the total amount of bonds outstanding. We also agree that we will keep on hand two years' debt service, so that if we have an earthquake, let us say, and the George Washington Bridge goes down, or the Lincoln Tunnel is affected, pending reconstruction, we would be able to carry on and pay interest and amortization, at least for a two-year period. Then, also, we must pledge that we will not go into a new facility unless we can demonstrate that our revenues amount to at least 1.3 times the maximum debt service of all future facilities. This is a way of preventing our getting into any unsound projects. In addition to that, the bonds provide that the commissioners will not get into any new projects unless they file a certificate stating that in their best judgment they will not detract from and adversely affect the continued good credit and economic soundness of the Authority.

Q *Mr. Tobin, anyone looking at the Authority from another world might well wonder how we reconcile the idea of free enterprise with the idea of a public corporation of this type.*

A A self-supporting public corporation such as this operates in a very narrow band of public service. We come in where the facilities are not attractive enough financially to be carried forward by private enterprise. We can do the job if we feel that with good management the facilities can be made to produce sufficient revenues so that, with the advantages that a public corporation has, they can be made self-supporting.

Q *What are the advantages you refer to?*

A In the first place, the bonds we sell, like bonds of a state agency, are exempt from federal taxation. This results in a saving of about 25 per cent in lower interest costs. For example, the three-sixty bonds we sold recently probably would have been about four-sixty, had they been subject to federal tax, as are the bonds of a private corporation. This is a critical matter. Now, also, under the laws of the two states,

we must pay to the city the maximum amount of taxes yielded by any property at the time we acquire it. When the Port Authority built the Bus Terminal on the square block bounded by Eighth and Ninth Avenues and 40th and 41st Streets, the City of New York was receiving $140,000 a year as taxes from the old tenements and stores that were there. On the Bus Terminal, we now pay the City of New York every year that full $140,000. But we don't pay them any taxes that would reflect the value of the new building. That is one of the reasons why no private company could have afforded to put up the new building at $25 million. Even so, the facility's returns were marginal until now. After 10 years, we're only now at the point where we are starting to break even. If we had to pay full taxes on the property, as a private corporation would have to pay, we simply could not have built the terminal. It would have had to be built and supported by the taxpayers of the city. And the same is true of the piers, airports, tunnels and other Port Authority facilities. Of course, as a public corporation, the Authority has no stockholders, nor does it have any federal corporate taxes to pay.

A tribute to the American system of government

Q *Would you say that the advantages of the Authority make it a better way of doing business than private profit-making enterprises?*

A Let me say that if the private bus companies could afford to build and run their own appropriate terminals, and the airlines their own airports, as proud as I am of the Authority's operations, I nevertheless would be inclined to believe that as a broad economic matter, the private business structure would provide a better basis for such enterprises. But they simply cannot do it under our present tax laws and still produce a profit.

Q *So there is a combination of economic and political reasons why private enterprise cannot do these things?*

A Yes. But that is not necessarily an indictment of our system. On the contrary, I think it is a tribute to the virility of our system of government that we have shown this ability and determination in adapting ourselves to these problems in this way. In other words, there isn't any inflexible form within the democratic political system.

As new demands arise in the public interest, the democracy responds to challenges with many types of administrative forms that will meet the problems. There is an old quote of Alexander Pope that says, "For forms of government let fools contest; whate'er is best administer'd is best."

Q *We can say, then, that the Authority is a special situation, a kind of halfway house between free enterprise and full public ownership of all productive facilities.*

A Yes, I'll not quarrel with that definition. I would add one qualification, however. The Port Authority is the creature of the states of New York and New Jersey. Nevertheless, it depends upon the competitive bond market to finance itself. To this extent, it is a part of the general economic system.

Q *What are the outstanding commitments of the Authority today?*

A Our capital budget over the next five or six years will require the raising of something like $700 million in new capital funds for the continued development of the airports and piers, or such projects as the second decking of the George Washington Bridge, which involves an expenditure of something like $180 million alone, or the construction of the Narrows Bridge, which will cost $320 million. We have at the present time some $570 million worth of bonds outstanding.

Q *What is the Authority worth?*

A Well, the Authority has built, is building and has contracted to build about a billion dollars' worth of facilities.

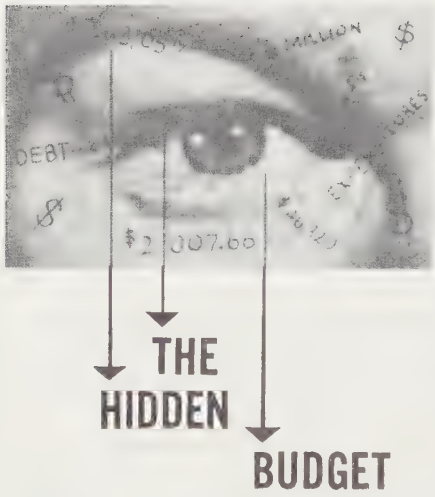
Q *That goes back over how many years?*

A That goes back some 38 years. Actually, the capital budget for the next 10 years will be a full billion dollars.

Q *In other words, the Authority will be spending as much in the next 10 years as it has all through the first 20-odd years of its existence.*

A That's right. Neither time nor the needs of this great port area stand still.

Q *Thank you, Mr. Tobin.* ■



Contradictions in spending policy help the nation economically—with some doubtful political results

by **Edwin L. Dale**

■ IS THE schizophrenic accounting system of the government, as reflected in the federal budget, an important impediment to sensible economic decisions and economic policy in the United States?

This is a serious question. The government in the next fiscal year will spend not $77 billion as the headlines say, but some indeterminate sum above $100 billion. The "budget" is a scramble of pure spending for current purposes, loans and other expenditures that acquire assets, and spending that is simply payment by one government agency to another.

We pretend–and believe–that Congress accepts or rejects the President's "budget," meaning the $77-billion expenditure estimate in the headlines; and yet Congress in one recent year cut appropriations by more than $5 billion without one dollar's reduction in the original expenditure as estimated. We put federal aid to highways outside the budget and federal aid to airports inside it. Such major activities as the Federal Home Loan Bank System, the secondary mortgage operation of Federal National Mortgage Association ("Fanny May"), the Panama Canal Zone government and rural electrification loans are treated differently for budget purposes, even though all are "business-type" activities of the government.

We find the President in favor of more college dormitories and in favor of the government help-

ing to get them built, but urging the device of a federal guarantee of a private loan instead of a direct federal loan, even though the "inflationary" impact of each is precisely the same. Indeed, the whole system of federal guarantees, chiefly for housing, has made it almost impossible to assess the true economic impact of federal financial activity–if the budget itself were not enough obstacle. Last year, for example, the single action of Congress that probably did more than any other to help thwart the recession was not a fiscal action at all but a raise in the permitted interest rate in the G. I. housing program. By the same token, the Secretary of the Treasury is persuaded that the singlemost effective Administration action–as distinct from the automatic stabilizing effect of unemployment compensation–was a speed-up in the disbursement of nearly $3 billion in tax refunds, and he may well be right. This did not show in the budget at all.

So much for the catalogue of horrors. We can return now to the original question: Does this system seriously impede sensible economic policy?

My answer, perhaps surprisingly, will be that, on the whole, it does not. I shall even argue that the system has some positive merits.

By "sensible economic policy" I shall mean orthodox countercyclical fiscal policy primarily: deficits in slumps and surpluses in booms. I shall deem a system to have "merit" if it also has these characteristics:

•A tendency to offset innate political irresponsibility–the inclination to spend more and tax less. To ask for this type of fiscal "restraint" is not to oppose higher spending but simply to accept the view that there is an inflation problem and that continued real deficits in the budget would be harmful.

•A method of insulation against periodic waves of Congressional sentiment. Under the parliamentary system this is not necessary. But under our system, there could be trouble if Congress had direct control over the actual expenditures of the government within a given year. It is much better to let Congress *think* it has control without actually having control.

First then, to orthodox countercyclical policy.

Despite the long list of anomalies about the budget, I believe that only two are of major importance for economic policy. One is the "trust funds" and the other is "guarantees." My hunch is that both work for, rather than against, necessary countercyclical policy requirements.

In a major sense, the trust

funds are the biggest trick of all about the budget. Their main activities are the social security system, unemployment compensation, railroad and civil service retirement, veterans life insurance and the highway program. These activities will spend an estimated $20.3 billion in the next fiscal year, not a penny of which is included in the "budget" of $77 billion that everyone talks about. Yet the checks come from the Treasury like any other checks, and the Treasury's debt management operations–including its need for cash–depend on the fiscal position of these activities as much as on any other.

The main justification for trust funds is the concept of earmarked revenues. With the exception of the highway program, a second characteristic is actuarial, that is, the building up of assets in advance of an anticipated heavy drain in the future. It is the "insurance" system.

Effect on fiscal policy

Again, with the possible exception of highways, there is nothing essentially wrong with the fundamental idea. These are, in fact, insurance-type activities and the "revenues" are in a real sense premiums. But how about the effect on fiscal policy?

The two trust funds that really count are social security and unemployment insurance. And both work beautifully in the countercyclical sense. Their expenditures increase automatically in slumps–particularly those of the unemployment insurance fund–and their receipts fall. In booms their receipts increase, and the expenditures of the unemployment fund, at least, decline.

This merit is now generally accepted. But some critics have complained that the failure to include the trust funds in the "budget" has imposed an arbitrary restraint on federal spending. They point out that in many years in the recent past these funds were running a large surplus of receipts and that the total "cash" position of the government permitted a deficit in the regular budget without economic harm. That is, a policy of balancing the ordinary budget would mean a sizable surplus in the true cash sense–a surplus perhaps unnecessary in the economic circumstances.

Recently, this argument has lost some meaning because the trust funds have not been running big surpluses, even in good years. But assuming they were, or started again under their present tax schedules, I suggest that this is salutary rather than the reverse. I am persuaded that bigger true surpluses during the 1955-57 boom would have significantly helped

to moderate inflation–an admittedly debatable point–and therefore that any system that "tricks" the government into running bigger surpluses is a good one. The perfect example is last year's social security tax increase. Congress did not dream of increasing benefits under the system without raising taxes as well. If inflation is to be our long-term problem, surely a system that produces such a result is the best possible system. If social security had been part of the regular budget–as public assistance grants to the states are–there would be repeated benefit increases without any automatic and corresponding tax increase, and possibly without any tax increase at all.

Guarantee system

Now for the guarantees. Here the case is much less clear cut. There is no doubt that, in theory at least, the trickery here could work the other way. That is, the government could promote a great deal of activity–inflationary activity–without any check because no budget expense is involved. The guarantee system could theoretically work toward fiscal irresponsibility, in the opposite way from the trust funds.

But the key word is "theoretically." In the real world, I suggest, the guarantees actually work the other way. There are two reasons.

One is that, so far, the only important guarantees, in amounts, are in the housing field. If we are talking about economic impact, size counts for everything.

The second is that Congress has economically foolish ideas about interest rates. It wants interest rates low, no matter what the state of the demand for the supply of savings.

This combination makes the federally guaranteed housing programs a quite brilliant countercyclical device. The record of 1956-58 can leave no other conclusion.

Because of the artificial interest ceiling, there was a steady fall in housing starts under the two federal programs starting early in 1956. The law kept the rate too low to attract lenders; they withheld their money, and housing lagged. This may have been bad "socially," but economically it was just what boom times required. Any more housing activity in 1956 and 1957, I am reasonably sure, would have pushed the price indices a shade higher than in fact they were.

Then when the recession came and Congress made a modest increase in the ridiculously low interest ceiling for the G. I. program–these programs quickly became attractive again to lenders. First applications, and then starts, zoomed. There can be no quarrel

at all with the conclusion that housing in 1958 was a major countercyclical activity.

There are some signs that Congress may start showing some economic sense about interest rates in these programs. If it does, then my argument collapses. But as long as the ceiling remains, we have in our only significant guarantee program a quite helpful countercyclical device. One can, as it were, hope that Congress fails to see the light.

The final merit of the present system is its method of escape from immediate Congressional control of spending. This is particularly important in the "national security" area. Under our present system a wave of Congressional economy sentiment is incapable of causing severe, immediate damage to our defense and foreign aid programs because a year's expenditures in these programs result from past years' appropriations primarily, rather than from current appropriations. Thus a cut in the current appropriation–the only way Congress can "cut the budget"–leaves the spending stream pretty well intact, at least for a year.

For Congress votes spending authority, not spending. Say it votes $500 million in 1955 for an aircraft carrier and the next five budgets reflect the resulting expenditures without further Congressional action. If in 1957 there is an "economy wave," the carrier proceeds on schedule. The economy wave does mean fewer carriers in 1959 and 1960, but not immediately. Thus the basic programs are not disrupted as much as the Congressional votes on appropriations bills might imply.

This is not to imply that Congressional control of spending does not exist, nor that votes on appropriations and other types of spending authority are unimportant. It is only to say that this Congressional control is incapable of producing major *immediate* changes, and that the executive is thus not as hamstrung as he might be under a system in which Congress controlled year-to-year spending.

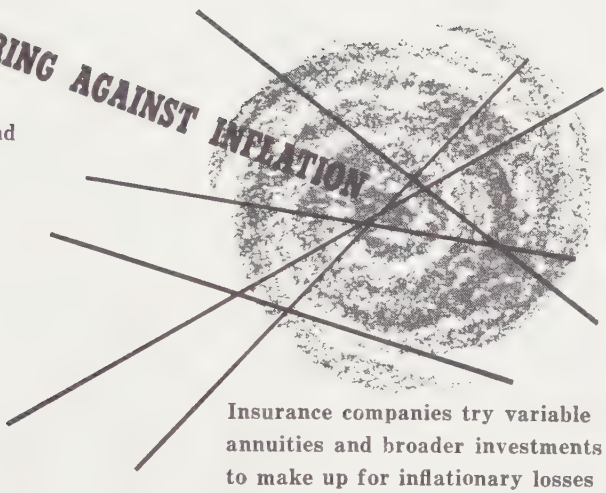
Of course, such methods do not give the people and their representatives a say about the size of *this year's* budget. But it is probably best that they do not have a say. The inescapable virtue of the present system is that it works. ■

Landowner

THE FEDERAL GOVERNMENT owns 769,700,000 acres of land worth, with installations, almost $46 billion. The holdings are located in all of the 49 states, seven territories and possessions and in 108 foreign countries. In Alaska and Oregon, the government owns more than 50 per cent of total acreage.

REINSURING AGAINST INFLATION

by William C. Freund



Insurance companies try variable annuities and broader investments to make up for inflationary losses

■ A FRIEND of mine recently posed a question which seemed to be disturbing him: "Is it not true," he asked, "that life insurance companies have made enormous inflation profits at the expense of their policyholders?"

I explained that life insurance companies are allowed by state laws nearly everywhere to invest only a tiny fraction of their assets in common stocks. The rest must go into bonds, mortgages and other fixed-dollar investments which depreciate in purchasing power along with the value of the dollar. Insurance companies could gain from inflation only if they paid claims in depreciated dollars while investing in stocks or other equities which rise with the cost of living. However, in fact, not only the claims against insurance companies but also their investments have been declining in purchasing power.

Insurance companies have therefore suffered from inflation along with their policyholders. While their expenses of doing business have gone up, they have found it difficult to raise their investment income and premium charges proportionately. The return on life insurance company investments, while rising in recent years, is still below the levels attained in most years before the war.

The question whether insurance companies have gained from inflation loses its meaning altogether in connection with "mutual" insurance companies–a category into which a large number

of our bigger companies fall. Mutual insurance companies have no stockholders. They are owned by their policyholders, and any earnings not needed in running the business are paid back to the policyholders in the form of dividends. Unfortunately, these policyholders have seen inflation take a heavy bite out of their insurance savings, while the low rates of interest earned by life insurance companies have reduced dividends.

Inflationary biases

Our economy is shot through with inflationary biases. Whatever one may think of farm price supports, wage increases exceeding productivity gains, noncompetitive pricing by business, and our national determination to maintain full employment–all of these forces are actively at work to push prices upward by the "ratchet effect." Prices rise strongly in periods of prosperity and only moderately in periods of recession.

Insurance is bought to achieve certain objectives–to provide for the family in the event of death and to accumulate funds to meet specific purposes during the policyholder's lifetime, perhaps education for the children or retirement income for the insured. Whatever the goal, inflation increases the total funds needed to realize these objectives.

Death benefits large enough to protect the family a few years ago no longer provide an adequate standard of living. Retirement income sufficient a decade past is woefully inadequate today. The sum set aside through insurance to pay for a college education goes only part way today.

Inflation, of course, reduces the purchasing power of all types of saving; but its effects are felt with particular acuteness by the holders of insurance policies. Life insurance contracts typically cover a long period of time. This gives the forces of inflation an opportunity to inflict a compound type of savings destruction.

Even a creeping rate of inflation, say an average of two per cent annually, leads to a 22-per-cent loss of purchasing power over 10 years, a 49-per-cent loss over 20 and an 81-per-cent loss over 30 years. These time spans are quite common in life insurance. Actuaries estimate that in the case of an ordinary type policy issued at age 30, about 38 years elapse on the average between the time the policy is issued and the time benefits are paid.

In the case of retirement income, the time span during which inflation can take its toll is even longer. A retirement fund is typically accumulated over a working life of about 30 years. Add to that a life expectancy of 15 years upon

retirement at age 65 and it becomes clear that an annuity for life can easily involve over half a century.

Consider the case of the person who retired in 1920 on the basis of a traditional retirement fund accumulated during a 30-year working life. He would have seen the purchasing power of his accumulated pension fund cut in half even before his first year of retirement. Even in 1932, at the very depth of the depression, he would have suffered a 30-per-cent depreciation in the purchasing power of his pension.

Damaging effect

Our retired people are least able to bear the burdens of inflation. Between 1940 and 1957, the *real* income per working person in the U.S. increased by more than 50 per cent, while the purchasing power of retired persons on a fixed income *decreased* by the same percentage.

The lower real income of our retired population has had a damaging effect on the economy in general. Retired persons have had to cut back on their savings, reducing in turn the funds available for the noninflationary financing of our growing economy. Moreover, to the extent that these persons have had to reduce their consumer purchases, business activity and employment have suffered.

Inflation hurts not only the policyholder by steadily reducing his purchasing power, but it harms the entire economy by discouraging saving. The public becomes more concerned with "staying ahead of the game," more prone to spend for immediate consumption, more likely to favor speculation over real investment. The expansion of our economy depends upon a steady and increasing flow of savings to finance the construction of factories and roads, of houses and schools.

When the job of capital formation is left to the commercial banks, that is, to bank-created money, the result is likely to be more inflation. Since the end of the war, new savings have fallen short of new investments by more than $30 billion, with the gap being filled by the commercial banks. The result has been an intensification of inflationary pressures.

In the past, insurance companies have played a prominent role in mobilizing the supply of savings from more than 100 million Americans. They have invested their funds at the highest possible rate of return consistent with safety. Thus, wherever the demand for capital funds was greatest, wherever the investment return was most favorable, life insurance companies stepped in to fill the need. In recent times, their investments have covered a wide

range, from the financing of commercial jets to the exploration of oil, from the building of new plants to the erection of shopping centers and new homes. The net new funds supplied by life insurance companies have been over $5 billion a year.

Now there are signs of a slowing down in the savings furnished by the life insurance companies. Their combined assets are no longer growing at the traditional rate of seven per cent annually, but at a pace only three-quarters as fast. Inflation has had something to do with this development. In recent years, the public has been buying a larger proportion of so-called "term" insurance, or nonpermanent insurance, which has hardly any savings element in it at all. In just 10 years, the proportion of term insurance in force has increased from 20 per cent to more than 40 per cent. Those insurance policies which include a large savings element have shown a corresponding drop.

Inflation and public opinion

The insurance industry has been much concerned about the results of persistent inflation, both on the policyholder directly and on the American economy through the discouragement of saving. In terms of public policy, the insurance industry has tried to mobilize public opinion against inflation. Some, but not all, companies are considering the use of the variable annuity to encourage the flow of savings.

The purpose of the variable annuity is to provide reasonable protection to retired persons against major fluctuations in the cost of living, and to permit them to participate in our rising standard of living, by investing a proportion of their annuity contributions in a diversified portfolio of common stocks.

Reliable studies, going back over 50 years, show that *over the long term* the prices of a large group of common stocks went up and down much as the prices of commodities in general, although the swings in stock prices were more severe than the fluctuations in living costs. The same studies show that during this period, if individuals could have used about half their retirement savings to buy variable annuities based on common stocks and had put the rest of those savings into fixed-dollar annuities, the combined income from the two types of annuity would not only have provided a fairly constant amount of purchasing power, but also a rising standard of living.

Contributions to a variable annuity would be invested in a broad list of common stocks. Upon retirement, the variable annuity contract would *guarantee an in-*

come for life, much as a fixed-dollar pension fund now does. But instead of guaranteeing dollars, which are likely to suffer a deterioration in purchasing power, the retired person is guaranteed an income of a fixed number of *units* each month. The value of each unit would then reflect the investment experience of the variable annuity fund.

Variable annuities are now being sold to teachers by the College Retirement Equities Fund and by several smaller companies in Washington, D.C. and Arkansas. Legislation to enable insurance companies to sell variable annuities is now pending in New Jersey and a few other states.

Key to growth

Suggestions have also been put forth to allow insurance companies to invest a larger proportion of their assets in common stocks. Over the long run, it is argued, the combination of capital appreciation and higher rates of return would allow insurance companies to increase their dividends to policyholders and thus to compensate them in some measure for the effects of inflation. British insurance companies now hold more than 25 per cent of their assets in equity-type investments, compared with less than four per cent for their American counterparts.

Greater stockholding by life insurance companies, it is argued, would stimulate larger savings by the public and thus increase investments in productive facilities --the key to a growing economy. It would also provide policyholders with a degree of protection against the insistent rise in the cost of living.

The proponents of greater equity investments by life insurance companies point to the large demands for common stock capital which lie ahead. The Research and Statistics Department of the New York Stock Exchange recently prepared a study of the flow of new money into common stock investment needed to sustain economic growth. Over the coming decade, the Exchange estimated that equity financing will have to be increased three- or fourfold to a rate of six or seven billion dollars a year.

G. Keith Funston, President of the New York Stock Exchange, has stressed repeatedly that if corporations are not to become overbonded, if our growth is to be soundly based, business must rely less on debt and more on equity.

What are the best ways of dealing with the impact of the inflationary trend on the insurance industry, its policyholders and our economy in general? The industry has proposed some answers, while continuing to give much thought to the question. ■

bad name

The anomalies of the present economic situation are reflected in anomalous actions taking place in Washington. If observers were persistent about giving the whole complex of factors a name, they could, at least, begin with the word, "inflation" and go on to the uglier word, "unemployment." Bankers and money men were giving more emphasis to the first name, an approach that explained the increase of the discount rate for Federal Reserve banks in a number of major cities from 2.5 to three per cent.

clipping penalty

The action of the U. S. Treasury in setting up an inquiry into the collapse of bond prices also resolved, if in a more eccentric way, around the same problem. Treasury suspicions of speculator manipulations, however, were intensified by the Department's desire to find a villain for an embarrassing situation. The Treasury was looking for an excuse for its failure to sell bonds the way it wanted at prices it wanted. But even if it did discover clever dodgers among the coupons, the real culprit would remain unpunished. The government was not selling its bonds because purchasers could make more money, or expected to make more money, in the equity market. If the Treasury inquiry wanted to stop at midstream, it could splash the blame on the profit motive.

price warranty

The FRB acted the way it did about the discount rate, and the Treasury is acting about speculators, to whom it is normally happy to sell bonds, in the way it is doing, because of the double problem of inflation *cum* unemployment. The economy had maneuvered itself into such a position that it was impossible to plan for stable prices without attempting actions tending to worsen the unemployment problem. The FRB was implying that it hoped someone else would worry about unemployment as it attempted to stem what it saw as a rising tide of inflation. Yet if prices have been stable over the recent months, the FRB had every historical reason to beiieve the stability was fragile.

by the gross

Unemployment approached the spring thaws still frozen at the near-five-million figure. Manufacturing work forces, down a half million from last year's 16,250,000, were producing five per cent more goods. The adjustment for the increased productivity had taken the gross form of joblessness. The effects of the situation were to make problem areas of certain manufacturing regions while the rest of the country enjoyed the prosperity revival. The question remained, while labor leaders were talking about a 35-hour week, whether the general prosperity would take specific effect on unemployment before it was countered by the anti-inflationary actions of the FED.

salem story

It was obvious that the situation would not be solved by manipulations on the part of the FRB or pious witch hunts by the Treasury. It was, however, not impossible that unplanned relief would come as the economy responded to other stimuli. Yet the problem would remain, even if Detroit's most optimistic predictions of car sales came true.

neutral drive

The auto industry had reason for measured hope, as sales rose to a level 15 per cent over the same time last year. But the response was not much better than

sluggish, in view of last year's dismal record and this year's rising consumer incomes.

C.C.C.

Consumers were addressing the future with cash and credit. Installment credit was continuing a rise that began almost six months ago. Consumers were planning to buy new automobiles, but they showed more enthusiasm for homes. Nearly 10 per cent of American families announced themselves to be in the home-buying market, an intention that had taken concrete form already in booming home construction. Spending for new homes was more than 25 per cent above the rate at the same time last year.

old room

While manufacturing was happily receiving new orders at a rate substantially above that of last year, business leaders were not rushing to build up plants. Private construction for manufacturing plants was still down by about one-third from the level of the same time a year ago. Reasons included excess capacity, increased productivity and a recession-emphasized caution.

* * *

politics again

WASHINGTON–The political battle lines are firm- ing up much faster than could have been anticipated just a few short weeks ago. Lost in the fray is any profound consideration of what the final size of the budget is likely to be. Some very deep-rooted differences have developed over federal aid to housing and the amount of money the Defense Department will need during the next fiscal year. The President is going to be pushed, and pushed hard by the Democrats. George Meany's open chastisement of the President on this issue makes it clear to Democrats that housing is a more than usual popular theme with labor, and labor can make or break many Democrats.

colder than ever

As for demands that the Administration be more liberal with defense expenditures, this issue is tied intimately to basic strategic and political problems. The Democrats have the word of leading military figures that further cuts at this time would be near fatal. There is a growing feeling that the Berlin crisis is not going to lead to any war, but instead to a prolonged period of on-again-off-again talks, which means more cold war, probably colder than ever. Thus, the Democrats want increases in conventional arms. Disarmament, they believe, is a dead letter. The balanced budget, therefore, must take second place. On top of all this, criticism from Democratic ranks of Lyndon Johnson's methods makes that influential Senator eager to jump at the Administration on any issue that seems to have the potential of becoming a major one. Hence, his investigation of our whole defense set-up.

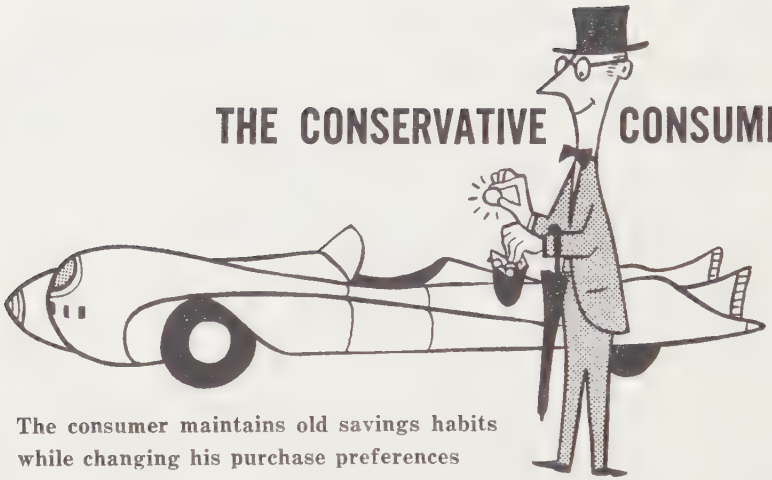
Orient Express

The Berlin to Baghdad route is historically a very famous one, but it was never traveled so rapidly as when Khrushchev made his conciliatory gestures from East Germany and reaped an anti-Communist revolt in northern Iraq. As of this writing, the revolt seems to have fizzled, but this is not the end of it. The Communists want to turn this episode into a complete victory as an answer to the pacts signed by the U.S. with Iran, Turkey and Pakistan. So Premier Kassim is in trouble. Now he must go all the way with the Communists, or listen to the siren songs from Cairo. Either way there is trouble ahead for the West.

profit picture

There are still wide differences of opinion about the future course of the business economy. But the way it looks now, there are definite signs that the business recovery will slow down during the second quarter, and then definitely level off for the rest of the year. But profits will be 25 per cent higher, which means near-record levels. No doubt organized labor will use this in upcoming bargaining sessions. In fact, it looks more and more like some rough bargaining sessions are in the offing. ■

THE CONSERVATIVE CONSUMER



The consumer maintains old savings habits while changing his purchase preferences

by F. Thomas Juster

■ THE average American consumer has almost twice as much real income to spend today as he had in the Thirties. His life has therefore been under the agreeable onslaught of a steadily increasing number of material goods, a sum of automobiles, new homes and household equipment that have made for revolutionary changes. Yet the consumer himself has remained remarkably stable despite all the variations in physical detail of his daily living.

It might appear that rising income levels and an attractive array of new products would cause the private individual to change his thrift habits. But this has not been the case. He was saving, in liquid form, about six per cent of his disposable income in the Twenties; the savings rate from 1951 to 1956 was the same six per cent. Economists conclude that there is no indication of any secular change over the entire period in the ratio of consumer liquid savings to income. Changes have, of course, occurred within the major classifications of consumer spending.

Durable goods–especially the so-called "big ticket" items like automobiles and washing machines–have expanded most rapidly. Semidurables like food, clothing and tobacco have grown less rapidly, and services such as housing, medical care and personal services, have grown at about the same rate as the semidurables.

Sharply differentiated rates of growth exist within each of these broad categories. Automobile expenditures have grown more rapidly than furniture and appliances. Food expenditures have grown more rapidly than outlays for clothing.

These differences occur in terms of three main factors. As real income increases in size, the pattern of expenditures is subject to systematic change. Put most simply, expenditures on so-called "necessities" tend to fall as a per cent of income, and expenditures on "luxuries" tend to increase.

The second important factor is the structure of prices and one of its major concomitants, the differential impact of technological change. Finally, the needs of consumers change in relative importance, partly because their incomes are rising, partly because new goods are discovered or invented which are more efficient in satisfying wants, and partly because wants may be created by either social pressure (keeping up with the Joneses) or by the pressure of advertising.

Looking at the changes in the expenditure pattern that have actually taken place, one can make reasonable guesses in some cases as to which of these factors is of most importance. Increased expenditures on durable goods seems to be most clearly related to the simple fact of rising real incomes. People who can afford it buy the leisure or pleasure provided by items like television sets, air conditioners, automatic washers, dishwashing machines and hi-fidelity sets.

An interesting side effect of this increasing emphasis on durable goods is that expenditures involved in their use, servicing and maintenance, also grow apace and seem to be about proportional to the total stock of durables. Consequently, one finds that expenditures for utilities (gas, oil, electricity) and repair shops have tended to grow more than income. On the other hand, expenditures for domestic service, less in demand because of displacement by machines, have tended to fall.

One normally expects to find that expenditures on food tend to decline as incomes rise. This is based on the ancient marginal utility argument–one can only eat so much food, hence consumption tends to grow very slowly regardless of how rich one gets. Yet, the fact is that over the period 1936-56, expenditures on food grew slightly *more* rapidly than either income or total expenditures.

The amount of money spent for food consumption is not, however, uniquely related to the tonnage of agricultural output. Part of our rising incomes have been taken in

the form of increased freedom for the housewife–witness the widespread use of packaged frozen food. Further, we have tended to increase both the average quality and the variety of our food consumption–beef rather than pork, steak rather than hamburgers, and more esoteric delicacies to brighten up the dinner table or the cocktail hour.

Quality and variety

Clothing constitutes a category with a rather different history. Expenditures have risen much less than incomes, despite the fact that the quality and variety factors have probably changed as much as in the case of food. The explanation may be that technological improvements in fibers, especially the development of low-cost synthetic materials, have tended to lower prices and increase durability. Clothing prices have risen somewhat less rapidly than consumer goods prices generally, and it is probably true that clothing now wears longer than a few decades ago.

One of the most striking features of the consumer spending pattern has been in the role played by the various services–housing, house operations, medical care, personal financial and business services, and private education. These expenditures as a group have moved at about the same rate as the total from the mid-1930s to the mid-1950s, but have expanded more rapidly than income since the end of World War II. Further, the rate of expansion seems to be independent of short-run fluctuations in income. Expenditures for services chugged through all three postwar recessions with hardly a pause (it would be impossible to locate any of these three periods of reduced income from the data on services). This is due partly to the fact that expenditures for many services are related to the stock of consumer durables–houses, cars and appliances–rather than to changes in the stocks. The stock of durables grows continually, of course, as long as new items being purchased are in excess of the scrappage rate.

The rapid expansion of expenditures on services since the war is probably attributable to the fact that many of these can be classed as luxuries, especially financial and business personal services, which are obviously more important to people as incomes increase. Similarly, medical care and private education, slighted at low-income levels, claim a higher priority as income rises. Further, technological progress is slow in services, causing an increase in their cost relative to commodities. Thus, a relatively higher fraction of income is probably spent for serv-

ices than would otherwise be true.

The data which we have discussed above throw little light on the future course of developments, or on such questions of current interest as whether the recent low levels of automobile sales are a consequence of the 1957-58 recession or represent a fundamental shift in consumer preference toward smaller cars and away from the large and relatively expensive automobiles. All that can be said on these questions is that changes in expenditure patterns will certainly take place in the future, and that most predictions as to the specific nature of the changes will more than likely be wrong.

Crucial relationship

However, we can say a good deal more about the over-all relationship among consumer expenditures, savings and incomes. This relationship is crucial for the analysis of business cycle movements. If aggregate consumer spending (hence also consumer saving) is tied closely to consumer income and varies only when income varies, the business cycle forecaster can safely ignore the consumer. If such is not the case, the forecaster ignores the consumer at his peril.

Historically, *the relationship between savings and income has been rather stable in the sense that we find no tendency by consumers to save either a larger or smaller fraction of income over the last 30 years, even though the level of real income has doubled.* As noted before, the percentage of income saved during the prosperous Twenties seems to have been just about as large as during the prosperous Fifties. Savings were relatively low during the depressed decade of the Thirties, extremely high during the wartime years of booming incomes and shortages, and again very low in the immediate postwar period when the accumulated shortages were made good. Since the late Forties, the rate of liquid savings has returned to its secular trend of around six per cent of disposable income.

One does find a good deal of short-run variability in consumer savings, belying the oft-expressed view that consumer expenditures–and hence consumer savings–are mainly or entirely related to consumer income. Most economists now recognize that the consumer spending-income relationship is affected by many significant factors in addition to the level of income, and that independent changes in the level of consumer spending have considerable consequences for the analysis of business cycle movements. Further, it seems quite likely that such independent changes will tend to be-

come more important as our society becomes richer.

A brief example will illustrate the critical importance of what at first looks like a minor fluctuation in the relationship between consumer spending and income. Disposable income has recently been running at the annual rate of some $300 billion. If consumers spend 95 per cent of income and save five per cent, they spend $295 billion and save $15 billion. But suppose they spend 93 per cent and save seven per cent–an apparently inconsequential shift. Consumers would then save an additional $6 billion, and spend $6 billion less. Such a modest shift in the rate of consumer spending would equal the total decline in business capital spending during the recent recession. Clearly, small shifts in the ratio of consumer expenditures to income result in very sizable changes in aggregate expenditures, and are quite capable of initiating or severely intensifying cyclical expansions or contractions.

Purchases and savings

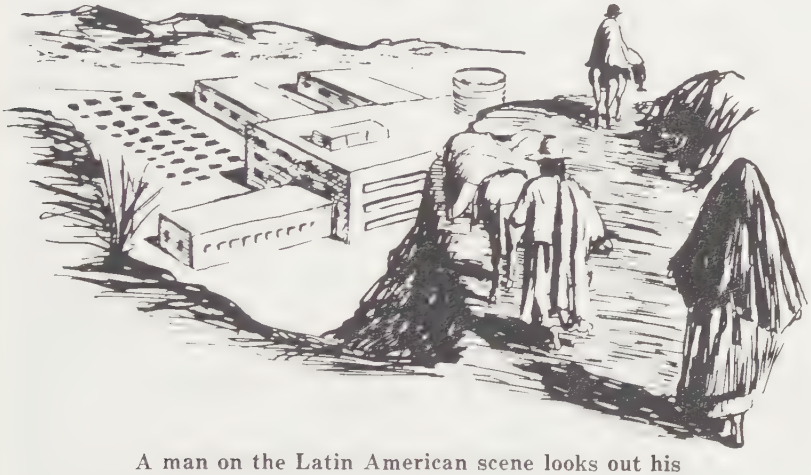
On the basis of the postwar evidence, it appears that short-run variations in savings are due to changes in the rate at which households acquire durable goods. When households buy relatively large amounts of durables, they save relatively small amounts in liquid form, and vice versa. In effect, durable goods purchases can be said to compete with liquid savings for the consumer dollar. Purchases of nondurable goods or services do not so compete.

Thus, in 1946 consumers were saving 7.7 per cent of their disposable income, while spending 10 per cent on durable goods. After this period of postwar shortages they began saving much less, reducing the ratio to 2.4 per cent in 1949 before reversing themselves to return to the secular six-per-cent level. The percentage of income spent for durable goods rose as the savings ratio fell, going to 13.9 per cent in 1950 and falling then to 11.5 per cent in 1954.

This relationship between durable goods purchases and savings has interesting consequences for the prediction and consequent control of business cycle movements. It seems clear that our ability to predict consumer spending in the aggregate is closely tied to our ability to predict changes in the purchase rate of durable goods.

How much will the consumer be spending on durable goods in the future? The question comes down then to the psychology of the consumer. Economists are calling on the help of the psychologists for answers that will be of enormous help in charting future cycles. ■

IS AMERICAN CAPITALISM EXPORTABLE? II



A man on the Latin American scene looks out his window to observe relevant answers in action

by John M. Hunter

■ IN AN entrancing coincidence, the article of Prof. Howard S. Ellis, "Is American Capitalism Exportable?" [CHALLENGE, October, 1958], came to my desk in Bogota the same day I had determined to start an article with the same title. My intention was to deal with a more limited set of potential "importers" of capitalism, the underdeveloped countries, and with a special facet of capitalism: competition. I have no quarrel with Prof. Ellis. Indeed, my topic complements his article.

American capitalism rests on competitive markets both in what producers buy and what they sell, however we try at times to avoid this rivalry. The philosophy of the federal government toward business in this respect is found in the Sherman and Clayton Acts which attempt to restrain monopolistic practices, or more positively, attempt to maintain competition. One cannot expect, then, to export capitalism without exporting its principal ingredient, the zeal for competition.

Competition assumes, in theory, many buyers and sellers, and perfect information on both sides of the market. It usually implies perfect geographic mobility of both productive factors and products. Practically, of course, these conditions are never met. But they

are in large measure operationally valid for the United States, so we experience "substantial competition" instead of the theoretical, textbook "perfect competition."

The characteristics of underdeveloped economies are such that competition cannot be "perfect" and is less than "substantial."

Markets are small

In the first place, these markets are small. Market size depends upon the limits of national boundaries, transportation systems available, per capita income and its distribution, population size, and the nature of the products themselves. Circumstances conspire so that practically all underdeveloped economies are "small market" economies. Frequently, they are small geographically, with tariff barriers surrounding them. Internal transportation is frequently poor and expensive. Per capita income is always low, since it is the poor countries that are by definition "underdeveloped." Even in cases where area and population are large, in Brazil, India and China, low incomes tend to keep markets small for most products.

The small size of the market has a particular implication for industrialization and competition in these countries, especially when it involves modern technology, with its high capital requirements. Suppose one of these countries wants to start a modern industry to produce its own glassware. It must buy its machinery abroad, from sources oriented to producing equipment for large outputs–literally tons per day. It may very well be that one or two of these production units will produce all the glassware that the market of this country can conveniently absorb because of its "smallness." In such a situation, it would be folly to insist upon competition (a half dozen firms?) because none of them would be able to survive.

Industries of this kind have indivisible production units because (1) there may be some economies of scale involved–as output increases, average unit cost goes down; and (2) even if this were not the case, the world demand for small-size production units is not sufficiently great to make it economically feasible to produce them. In such circumstances these countries do not have the choice between competition and monopoly. Their choice is between *production* and *no production.* Even when we find two or three firms in such industries, there is no guarantee that competition exists. They may be situated geographically so that transportation costs preclude *any* coincidental market area, much less mutual selling at each others' back doors.

Low levels of literacy and great poverty contribute to the difficulties of developing effective competition. Competition works imperfectly at best unless sellers of productive factors, including the agricultural peasant who sells his labor and use of his land, and buyers of consumer goods know the markets in which they operate. They must be aware of price behavior over time and the alternative uses and prices for their land and labor.

When this is not the case, we find the merchant middleman getting rich while the peasant "subsists," as well as the usurious money lender and other "exploiters"–all trading on the market ignorance of the peasant. If the "little man" could read and have access to daily newspapers or listen to market reports on the radio, he could improve his lot with the better information. But he is too poor for this.

Increases competition

The lack of cheap, efficient transportation contributes to the difficulties of competition in these countries. Road and highway networks may be impressive on maps, but until one drives a jeep over the magnificent *Cordilleras* of a country like Colombia, one has little appreciation of the costs and difficulties of transportation in some areas of the world.

Cheap, efficient, fast transportation serves to increase competition, of course, as it widens the market area around each producer and makes those areas already served by others potential sales areas for him. It matters little if a census shows 1,000 buyers of potatoes in a country when the *campesino* must take his crop to the nearest town by *burrito;* the one or two buyers there represent his *only* alternative. Nor does it matter much that there are numerous brick factories in the country if he has to transport his purchases home on the same *burrito.* Expensive transport limits the extent of the market and thereby reduces competition and the benefits therefrom.

Is American capitalism exportable to underdeveloped countries? Clearly the answer is a qualified "no." No, because the conditions permitting and encouraging competition are not present and will not be for some time. No, because American capitalism is unique to America and its circumstances. American capitalism, as we now know it, could not have been "exported" to the United States of 1850 for exactly the same reasons.

But we *can* export the philosophy which led to the development of 20th-century capitalism–exemplified by strenuous community efforts to provide public education, enormous expenditures for public

transportation, including railroads, extensive educational efforts in agriculture, respect for private property, encouragement of business and industry through a relatively *laissez-faire* approach while policing major malpractices, respect for the profit motive, and a realization of its accomplishments as well as of its shortcomings.

A second major conclusion follows from that first conclusion of the qualified "no." Many of the actions of these countries from time to time seem silly, if not downright dangerous. The "market mechanism" works not so well for them as it does for us, and many of their policies develop because they have no automatic economic devices to police economic malpractice. The countries are, in many cases, new-born democracies with all sorts of political pressures brought by an electorate that we would define as ill-informed.

Price control, for example, is imposed where it stands no ghost of a chance of success. In one such country, I saw the death penalty prescribed for hoarding, written to include the normal inventory speculation that most businesses perforce undertake. Middlemen are regarded solely as "exploiters," and not even partially as "producers," and are treated accordingly. Nationalization of foreign investments is undertaken, threatened, or just talked about. Prices of particular products are kept ridiculously low for political reasons.

We get impatient and sometimes frightened by these developments. We must learn patience because our capitalism *is not presently an alternative* in many sectors of these economies, not even in a theoretical sense. The political situation of such countries creates even more problems requiring patient understanding. We might remember more often the many disorders we endured to reach our present, still imperfect state. ■

Answers to Challenge Quiz

(see page 79)

(1) False *(see page 19)*
(2) False *(see page 48)*
(3) True *(see page 65)*
(4) False *(see page 38)*
(5) True *(see page 25)*
(6) False *(see page 34)*
(7) True *(see page 70)*
(8) False *(see page 9)*
(9) False *(see page 61)*
(10) False *(see page 15)*
(11) False *(see page 54)*
(12) False *(see page 29)*

THE PERMANENT FRONTIER

No. 14: the accumulation of capital sets the character of the nation after the Civil War

■ "FROM 1492 to 1865," writes social historian Bert J. Loewenberg, "American development was evolutionary; after 1865 it was revolutionary." Three major processes reshaped the economic structure and altered the character of American life: (1) the rapid development of industrial capitalism; (2) the rise of the modern city; and (3) the impact of immigration–all part of a single irreversible process.

Hindsight tells us that the United States required a certain economic emphasis in order to achieve maximum development in the years after 1865. Although there were few Americans who actually defined the problem, and although the idea of national planning was nonexistent, the nation did establish precisely the kind of emphasis needed: heavy capital investment that rose from the total of $1 billion invested in industry by 1860 to $6.5 billion by 1890.

By 1860 the nation had produced $1.8 billion in industrial goods since the beginning of its industrial history. In direct response to the investments, the value of industrial goods increased to $10 billion by 1890. The new corporate structure, the new technology and the rapid emergence of the "factory system" doomed the America that Andrew Jackson and Abraham Lincoln knew as boys.

Industrial capitalism reshaped the composition of the national labor force. In 1860, two-fifths of labor was engaged in *nonagricultural* employment. Thirty years later, the figure had risen to three-fifths, and in 1920 it stood at three-quarters.

Machine production and the

larger unit of industrial enterprise also profoundly altered the economic and social status of the worker. Skill became less important. The typical worker no longer labored in a small shop where, using simple tools, he arduously shaped a product from beginning to end.

Industrialism also facilitated urban growth; for, as John Hobson wrote, the modern city was "a result of the desire to produce and distribute most economically the largest aggregate of material goods." In 1840, one-twelfth of the population lived in communities of more than 8,000 persons. That ratio stood at one-sixth by 1860, and in 1900 one of every three Americans was an urban resident. Chicago grew spectacularly: its 30,000 residents in 1850 became 500,000 in 1880 and 1.7 million in 1900.

The large cities, moreover, grew in a rapid and chaotic manner. In 1894, 32 acres of New York real estate housed 986.4 persons to the acre. Prague, the most overcrowded European city, had 485.4 persons per acre in its most dense section, and Bombay counted 759.7.

Reshaped society

Immigration joined industrialization and urbanization to reshape the social character of the country between 1865 and 1900. More than five million temporary and permanent immigrants entered the country between 1865 and 1880; the next 40 years counted 23.5 million more immigrants, as the population rose from 50 to 106 million.

These same years also saw a shift in the pattern of immigration. Improvements in transportation, the relative absence of native industrialization, and the desire for a better life led millions of Southern and Eastern Europeans to the United States and other expanding industrial nations. By 1900, four-fifths of Chicago's population were immigrants or the children of immigrants. The number of Italians in New York equaled the population of Naples.

Immigration and industrialization blended together well in industrial terms. The unskilled peasant immigrants arrived in a country of constantly expanding factories which needed unskilled and easily trained semiskilled workers. In 1910, according to one careful estimate, the so-called "new" immigrants, along with Negroes migrating from the South, "made up two-thirds of all the workers in 21 major branches of American industry."

The entire nation was undergoing a profound economic and cultural transformation, and many older Americans, as Samuel Hays

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This is the fourteenth article of a series in CHALLENGE which deals with the history and development of the United States economy.

has written recently, "could not separate the strangeness of the immigrant from the strangeness of industrial change; both seemed 'foreign'." Anti-immigrant sentiment, therefore, appeared throughout the nation and, significantly, among some labor leaders. A New York newspaper could rail against the Irish and the Italians in 1888: "The flood gates are open. The horde of . . . steerage slime is being siphoned upon us from continental mud tanks." The immigrants, William Bernard has written, "were in a dilemma: if they did not join unions they were called strikebreakers; and if they did, they were called radicals."

Employment figures

Just as the new factory production attracted the unskilled immigrant workers so, too, did it draw upon women and children in large numbers. The census did not list those children under 10 years of age who worked, but in 1880 slightly more than one million boys and girls, aged 10 to 15, were gainfully employed. According to the same source, the figure stood at almost two million in 1910, about 5.2 per cent of the total labor force.

Similarly, the number of working women increased in these years. Two and a half million women, 15 per cent of the labor force, worked in 1880, and 20 years later the number of women had doubled, comprising 18 per cent of the labor force.

It is difficult to assess the conditions of living for the wage-earning classes during this prime period of industrialization, for adequate statistical data on wages, earning and working conditions are lacking. The well-known Senate report on these matters that was published in 1895 suggested that nominal *hourly* earnings for nonagricultural workers rose about 85 per cent between 1860 and 1890, while the cost of living rose only about 18 per cent.

But the wages of unskilled workers rose less rapidly than those of the scarcer skilled hands. A rough estimate of the distribution of income in 1890 by Charles Spahr showed that 200,000 families earned more than $5,000; 1.3 million families between $1,200 and $1,500; and 11 million families less than $1,200. The average wage of the latter group was $380 a year.

These figures take little account of working conditions in the latter half of the 19th century. A 10- to 14-hour day was commonplace in 1860, and though certain skilled workers labored fewer hours in 1890, laborers in the steel and paper mills, the oil refineries, and other highly mechanized industries worked 12 hours a day for six or seven days a week in 1890.

Seasonal unemployment aggravated the difficulties of workers in the manufacturing industries. A Massachusetts study in 1885 estimated that 30 per cent of that state's workers were without jobs for nearly five months. The fluctuations of the business cycle–severe industrial depressions between 1873 and 1879, and 1893 and 1896, along with several recessions–added to their troubles.

Finally, job conditions were frequently bad and dangerous. Factory inspection came slowly and haphazardly, and coal mines were inadequately ventilated. The "sweat-shop" system was widely used in the light manufacturing branches. Outside of the larger cities, furthermore, workers often lived in "company houses" and were paid in "company money."

Attitudes toward labor, particularly organized labor, were less than hospitable. The *New York World* admonished its readers, furthermore, that "the American laborer must make up his mind, henceforth, not to be so much better off than the European laborer . . . the workingman will be nearer to that station of life to which it has pleased God to call him."

Nor was this all. Strikers often faced hostile courts and state governments, unfriendly militias, and employers that used unfair contracts, private detectives and other coercive methods.

What explained the hostility toward the worker and toward the trade unions? Economic historian Ross Robertson writes that between 1860 and 1920, "Americans were at least half a century behind the times in their failure to realize that the agrarian economy, in which the individual did have some measure of control over his own destiny, was fast disappearing."

These were years of tremendous industrial change, a time of necessary and painful capital accumulation. Price competition was fierce. The business cycle wrought disaster on the inefficient and less capable entrepreneurs. The inadequate money supply encouraged a long trend of declining prices. All of these factors, therefore, also conditioned the outlook toward labor. Cost considerations –and labor was just a "cost" factor to most employers then–were crucial to businessmen that faced crisis after crisis.

Well-chosen statistics

It would be easy to paint a horror picture of living conditions from well-chosen statistics and quotations. The emphasis on capital investment and the weak barbaining position of the workers did mean a reduction in current income. But capital goods were being quickly transformed into

consumer goods, and the worker of 1890, who was making sacrifices for the worker of 1900, was nevertheless benefiting from the income sacrifices of the worker of 1880. In any case, even the most generous income redistribution would have meant but an insignificant wage increase, while the 1893 Senate report did document a substantial rise in workers' hourly earnings.

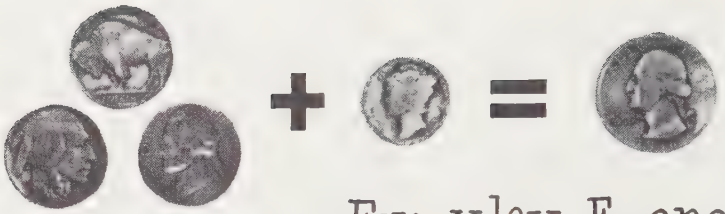
In comparison with the already highly sophisticated economies of Western Europe, the United States could still be defined as an underdeveloped country. It was engaged in building basic facilities like transportation and training the labor force to exploit its natural wealth. Yet the American worker's income compared favorably with that of his French or British counterpart.

Most of the hardships could not be attributed to anything as simple as the villainy of conscious exploitation. Progress was hard on everyone, and businessmen went bankrupt with distressing frequency. Moreover, if the incomes seem low to us today, they often represented an astonishing state of well-being to an immigrant who had worked from dawn to dusk and gone barefoot most of the year in his native Balkan village.

It would also be easy to exaggerate the anti-immigrant feeling. Few nations have received so many new people in so short a span of time and with so few frictions. Resentment was often short-lived as the older citizens made room for the newcomers with their strange customs.

Conditions demanded improvement as the capital goods boom rolled over more human demands. The dynamics of the economy ran away from the unions, and the established ones had difficulties in surviving. The Knights of Labor, something of an experiment in democratic industrial unionism, fell away almost as quickly as they rose to power. Stable unionism came only to certain crafts, such as the building trades and the printing trades; but the skilled insulated themselves from the mass of unskilled workers. Samuel Gompers' American Federation of Labor made some headway in the 1890s, but as late as 1898 no more than 500,000 of the nation's 17 million wage earners belonged to trade unions. It was the capital-goods boom and the accumulation of real wealth that established the character of the developing nation. ■

NEXT MONTH: the consolidation of business to meet new technological developments



Everyday Economics

■ ALL APPLICANTS for federal employment undergo investigation by the Civil Service Commission. There are two basic types of investigation: the *national agency check* and inquiry consists of checking the files of major government investigative agencies, and of written inquiries to references, previous employers, schools and police departments. This check is made on applicants for positions with duties that do not affect national security. A *full field investigation* is made on persons assigned to sensitive positions. This involves a national agency check, personal interviews with former employers, neighbors and associates, and a check of police and credit records.

Sick pay

WORKMEN'S compensation that is received because of illness or injury is fully tax exempt. If compensation payments are turned over to the employer in return for payment of regular wages, only the difference between the wages received and the amount of compensation is fully or partially taxable. Teachers covered by a sick pay plan may not exclude benefits received during a vacation. A self-employed person may not exclude sick pay with respect to income from self-employment. A partner may not exclude sick payments from a partnership of which he is a member.

Vacationland

VETERANS who have received an honorable discharge are eligible to lease from five to 320 acres of vacant land. The veteran is granted a 90-day preference period over non-veterans. Also, his period of service (but not more than two years) is deducted from the three years of residence required to obtain a land-patent on homesteading lands. Most lands are located in the South, West, and in Alaska. The land may be used for resi-

dence, as a recreational site, or for business. A list of available tracts can be obtained from the Bureau of Land Management, Department of the Interior.

Taking stock

MOST dividends received by stockholders are taxable as interest. However, distributions which are not made out of the earnings of the company are not taxable because they constitute a partial or complete return to the stockholder of his investment in the company. When such a distribution is made, the stockholder is usually notified that the dividend is not taxable. It is important that a record of such dividends be kept because they must be reported as a capital gain to the extent that they exceed actual investment.

Past 65?

UNDER social security legislation a woman may begin receiving her monthly benefits when she reaches the age of 62 instead of waiting until she is 65. Should she decide to begin receiving the benefits before she reaches 65, the amount of her monthly benefit will be *permanently reduced*, the amount of reduction depending on the number of months between the time she elects to start receiving benefits and the month in which she reaches the age of 65. A working woman's monthly benefits will be reduced by 20 per cent if she chooses to receive benefits at the age of 62. For each month she waits after the age of 62, the reduction will be less. A woman eligible to receive insurance benefits as the wife of a man who receives social security retirement benefits will find her payments reduced by 25 per cent if she elects to receive benefits when she is only 62. Again, by waiting she can decrease the amount of reduction. However, if her husband should die, her widow's benefits based on her husband's earnings would not be reduced.

Taxes and tenants

LANDLORDS are not usually required to include as taxable income those amounts received as security deposits from their lessees. However, the deposits must be included if they are appropriated by the landlord because of the lessee's default. Security deposits are also taxable income in the year received, if they are to be applied as payment of the rent for the last year of the lease. Payments received from a tenant to permit him to cancel his lease are included in taxable income.–S.T.

The Pursuit of Happiness in the Democratic Creed. Ursula M. von Eckardt. 414 pp. New York: Frederick A. Praeger. $4.50.

•"The pursuit of happiness" was deemed a legitimate right of man in the Western world long before Jefferson declared it self-evident. As historians have pointed out, most non-Western cultures have until recently seen matters in a quite different light. And even in the West, Christianity has often regarded the right to pursue happiness as equivalent to the right to pursue sin. These complexities do not disturb Dr. von Eckardt for whom the "pursuit of happiness" seems even more self-evident than it appeared to Jefferson. She explains in great detail the books Jefferson read which led him to believe the way he did. But when it comes to discussing what this ideal means today, she has little to say.

* * *

Cities in the Motor Age. Wilfred Owen. 176 pp. New York: Viking Press. $3.95.

•A transportation expert makes a commendable attempt to connect the problems of his field to the more general concerns of urban existence. Owen has interesting facts to illustrate the dynamics of the city: an acre of residential land in Detroit generates 29 daily trips against 268 trips in the case of a comparable commercial area. Owen notes the solutions as suggested by leading experts, including urban-suburban political integration and a federal council on city problems. He is unfortunately too modest to add his own opinions, and the book suffers from a lack of philosophical definition. Why is a city, what is a city, what should a city be?

* * *

The Professor and the Commissions. Bernard Schwartz. 275 pp. New York: Alfred A. Knopf. $4.00.

•As chief counsel for a House investigating committee, Schwartz launched himself at the great regulatory agencies with a violence that achieved more confusion than correction. It was easy to prove that abuses existed, but Schwartz mixed in so much hysteria and so many unfair charges that the investigation disintegrated with his dismissal. It is doubtless true, as Schwartz claims here, that efforts were made to hamper a proper investigation, but an adept chief counsel would have maneuvered with patience and without an overexercised persecution complex. The book documents Schwartz's conceit and double standard of tolerance–shrill condemnation of others and great forbearance for his own "mistakes."

What's Wrong with U. S. Foreign Policy. C. L. Sulzberger. 225 pp. New York: Harcourt, Brace. $4.50.

•An American journalist attempts to deepen his daily perceptions with the assistance of history. Sulzberger picks such good masters as Pericles and Alexis de Tocqueville but he treats them like good news sources, skimming off pithy quotations and temporary relevancies. The book is a well-ordered catalogue of American diplomatic errors and anti-American sentiment throughout the world. It fails, however, to cut down to the principles that might indicate the extent of our incapacity and guide us to better policies. Sulzberger does not tell us what is really wrong with our foreign activities; he merely describes what has gone wrong.

* * *

One Great Society. Howard Mumford Jones. 241 pp. New York: Harcourt, Brace. $4.50.

•Prof. Jones makes an admirable plea for the humanities which, as he justly points out, have tended to be eclipsed in recent years by the natural and social sciences. But a true understanding of self or society is impossible without *humane* understanding. By allowing us to share the universal and unique experiences of other individuals and societies through art, music, literature, history and philosophy, the humanities give purpose, beauty and value to life. All that Jones has to say is, of course, true. But will it do any good? It is doubtful whether those who have never been moved by a Beethoven sonata or a Shakespearean sonnet will be moved by Jones' excellent brief. As for the others, they do not need to be convinced.

* * *

The Angry Scar: The Story of Reconstruction. Hodding Carter. New York: Doubleday. $5.95.

•Those who delight in historical narratives will find that Mr. Carter successfully unites the elements essential to holding and informing the average reader. This version of the oft-told Reconstruction story is saved from culpable repetition by a new selection of illustrative excerpts from the writings of the period. Carter, a Southern newspaperman, links yesterday's problems to today's headlines and concludes that memories of the Reconstruction explain much about Southern attitudes. A Southern political leader who heard tales of abuse and injustice as his mother's childhood memories is understandably regional-minded. The memories, says Carter, may live well into the future.

* * *

Federal Budget and Fiscal Policy: 1789-1958. Lewis H. Kimmel. 337 pp. Washington: Brookings Institution. $5.00.

•This is a remarkably perceptive study of the evolution of American budgetary policy from the signing of the Constitutional Convention to the present. Until the second New Deal Administration, all U. S. governments, no matter what their political complexion, sought an annually balanced budget at all costs. Today, both parties use the budget for countercyclical ends. Dr. Kimmel analyzes this "revolution in policy-making" sympathetically and is perhaps overly optimistic about

the effectiveness of recent fiscal policies as economic stabilizers. Be that as it may, any one interested in the economics of "flexible" finance will find this book helpful.

* * *

The Waist-High Culture. Thomas Griffith. 275 pp. New York: Harper & Bros. $4.00.

•Griffith, *Time* Foreign News Editor, surveys the American scene and finds it populated by "vibrating and mediocre" people. Since this pessimistic verdict is reached in terms of the author's own life history (which is the most interesting part of the book), the reader will perhaps deem it more applicable to Griffith than to America. There are the usual strictures against our materialism, our failure to appreciate quality and our moralism in foreign affairs, but the criticism is blunted by Griffith's evident inability to formulate standards different from those of the culture he criticizes. As he admits, he is very much a part of that flawed culture. While this does not necessarily disqualify him as critic, his book is an implicit rather than explicit criticism of certain features of the American way.

* * *

Political Power and Social Theory. Barrington Moore, Jr. 315 pp. Cambridge: Harvard Univ. $4.50.

•If American sociology survives Moore's treason it may make a worthwhile contribution to scholarship. Iconoclast even to what might become a personal idol, this educated sociologist achieves clear statements of the problems of power in terms of real issues: industrialism, conformity, dictatorship and the breathing, irritated individual. He is more successful in criticism than thorough in construction; but we may accept these essays as a clearing away of pedantic debris preparatory to a *grand oeuvre*. He warns against the possibility of "a decentralized and diffuse system of repression more or less willingly accepted by the mass of the population." He notes the dangers in social sciences caused by a specialization that eliminates all reasoned reflection about society. He suggests most valuably that it is nonsense to demand of social sciences the mathematical accuracy of the natural sciences. Moore's toughness extends itself hearteningly to a battle stance in nonacademic dangers: ". . . circumstances may rise when the only meaningful act open to the intellectual is to go down with his ship, with all banners flying and steam hissing from the boilers, on behalf of principles about which absolute certainty is impossible."

* * *

The Charm of Politics. R. H. S. Crossman. 243 pp. New York: Harper & Bros. $4.00.

•Crossman is a Labour Member of Parliament and a leading English left-wing intellectual. But these "political" essays of his are remarkably free of the usual ideological claptrap. He admires many of his political adversaries (Churchill, Butler) and is sharply critical of the ideological blunders that often make European Socialists so ineffective. He is convinced that the future of the Labour party depends on its ability to transcend its limited "working class" allegiance and attract middle-class votes. And, as this witty book indicates, he has plenty of ideas on how this can be done. ■

Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Ten correct answers is Excellent; 9, Good; 8, Average. If you do the quiz *before* reading the articles, 6 correct answers is good. Answers on page 68.

(1) The Council of Economic Advisers publishes a formal Economic Report to the President.
True ☐ **False** ☐

(2) The $77-billion new budget includes money to be spent from the federal highway program trust fund.
True ☐ **False** ☐

(3) The Sherman and Clayton Acts express the philosophy of the federal government as regards monopolistic practices.
True ☐ **False** ☐

(4) In Western countries with high per capita income, governments' share of national output is less than five per cent.
True ☐ **False** ☐

(5) In France, wage cost per unit of output is lower than in the U. S.
True ☐ **False** ☐

(6) Sales of consumer durables are more easily forecasted than are those of perishable items.
True ☐ **False** ☐

(7) By 1900, four-fifths of Chicago's population were immigrants or the children of immigrants.
True ☐ **False** ☐

(8) A Chinese peasant who joins a commune may retain ownership of up to an acre of land.
True ☐ **False** ☐

(9) Expenditures on food have declined while our income and total expenditures have risen.
True ☐ **False** ☐

(10) The Employment Act of 1946 establishes a stable price level as an explicit goal of economic policy.
True ☐ **False** ☐

(11) In the past 10 years, the proportion of term life insurance has decreased in comparison to cash value types.
True ☐ **False** ☐

(12) Paul-Henri Spaak was a Dutch resistance leader during World War II.
True ☐ **False** ☐

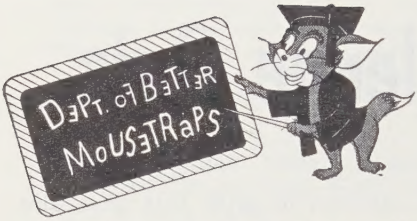


Photo Finds: A kit containing a fluid that enables home photographers to print their own negatives on paper, cardboard or cloth. A drop of fluid is spread on the surface to receive the print; the negative is placed on the treated surface and a piece of glass over the negative. After exposure to sunlight or photo-flood, the print is made without damaging the negative . . . For professionals, an automatic exposure control that is transistorized and battery powered. It adjusts the *f*/ opening in changing light conditions . . . Reels for developing tanks that self-load the film when a handle is turned, eliminating the hazards of hand-feeding.

* * *

Childrens' Corner: *For backyard batters, an automatic pitcher that can throw a straight fastball at desired height. When the batter is ready, he steps on a rubber bulb and the pitcher winds up . . . For the marble season, a "marble minder" that clips to the belt and dispenses marbles as needed . . . For children over 12, a radiation detection kit with samples of radioactive ore and all the parts needed to built a transistorized Geiger counter. With this precision instrument, the child can measure the day-to-day variations in the background count and detect the effects of atom bomb tests.*

* * *

The Home Workman: A window lock for all double-hung wooden sash windows that is key-operated and permits the window to be locked while partially open . . . Wire screens that attach with clamps to metal or wood gutters to shut out debris and prevent clogging of gutters, downspouts and dry wells . . . A tool with a magnetic retractor that holds small nails or brads in place while they are being driven into difficult corners . . . A tire inflator that comes in an aerosol-like container and can double as a fire extinguisher . . . A tricolor flashlight with a separately operated flashing red blinker light in the rear . . . A hammer with a head suspended in energy-absorbing materials to reduce bounceback (and fatigue).

* * *

Around the House: *A take-apart bucket with two sections, one for soapy water and the other for rinsing . . . A mechanical turntable for cakes that plays the happy birthday song . . . A knife with a blade edged in tungsten carbide that is kept razor sharp through use (even on materials that usually dull a knife) . . . A plant wick that will feed controlled moisture to house plants for up to eight weeks while the homeowner vacations.*

* * *

From the World of Industry: An electronic telephone answering unit that records all messages, permits businessmen to leave telephones unattended day or night . . . A vinyl-to-metal adhesive that permits stretching the product 35 per cent without weakening the bond . . . A control unit that converts any public address system into an intercom and paging system.

* * *

Write to CHALLENGE *for additional information.* ■